S. HRG. 100-830

UNITED STATES-CANADA FREE TRADE AGREEMENT

HEARINGS

BEFORE THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON THE

IMPLEMENTATION OF THE UNITED STATES-CANADA FREE TRADE AGREEMENT AND THE POTENTIAL IMPACTS ON ENERGY AND NATURAL RESOURCES INDUSTRIES

APRIL 19 AND 21, 1988

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE
90-254 WASHINGTON : 1988

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington. DC 20402

S311-81

COMMITTEE ON ENERGY AND NATURAL RESOURCES

J. BENNETT JOHNSTON, Louisiana, *Chairman*

DALE BUMPERS, Arkansas
WENDELL H. FORD, Kentucky
HOWARD M. METZENBAUM, Ohio
JOHN MELCHER, Montana
BILL BRADLEY, New Jersey
JEFF BINGAMAN, New Mexico
TIMOTHY E. WIRTH, Colorado
WYCHE FOWLER, Jr., Georgia
KENT CONRAD, North Dakota

JAMES A. McCLURE, Idaho
MARK O. HATFIELD, Oregon
LOWELL P. WEICKER, Jr., Connecticut
PETE V. DOMENICI, New Mexico
MALCOLM WALLOP, Wyoming
FRANK H. MURKOWSKI, Alaska
DON NICKLES, Oklahoma
CHIC HECHT, Nevada
DANIEL J. EVANS, Washington

Daryl H. Owen, *Staff Director*
D. Michael Harvey, *Chief Counsel*
Frank M. Cushing, *Staff Director for the Minority*
Gary G. Ellsworth, *Chief Counsel for the Minority*

CONTENTS

Hearings: Page
- April 19, 1988 ... 1
- April 21, 1988 ... 167

TUESDAY, APRIL 19, 1988

STATEMENTS

Bingaman, Hon. Jeff, U.S. Senator from New Mexico ... 2
Johnston, Hon. J. Bennett, U.S. Senator from Louisiana ... 1
Martin, William F., Deputy Secretary, Department of Energy, accompanied by Scott L. Campbell ... 73
McClure, Hon. James A., U.S. Senator from Idaho ... 7
Murkowski, Hon. Frank H., U.S. Senator from Alaska ... 143
Nickles, Hon. Don, U.S. Senator from Oklahoma ... 112
Yeutter, Hon. Clayton, Ambassador, U.S. Trade Representative, accompanied by Robert Reinstein and Charles Roh ... 10

THURSDAY, APRIL 21, 1988

STATEMENTS

Altmeyer, Thomas, senior vice president, government affairs, National Coal Association ... 275
Bush, Nicholas J., president, Natural Gas Association ... 197
Johnston, Hon. J. Bennett, U.S. Senator from Louisiana ... 167
McCormick, William T. Jr., chairman and chief executive officer of CMS Energy Corp., on behalf of the American Gas Association ... 175
Schleede, Glenn R., vice president, New England Electric System ... 251
Thomas, Robert C., president, Tenneco Gas and Pipeline Group, on behalf of the Interstate Natural Gas Association of America ... 168
Wonstolen, Kenneth A., executive director and general counsel, Independent Petroleum Association of Mountain States, accompanied by David W. Wilson ... 240

UNITED STATES-CANADA FREE TRADE AGREEMENT

TUESDAY, APRIL 19, 1988

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 2:18 p.m. in room SD-366, Dirksen Senate Office Building, Hon. J. Bennett Johnston, chairman, presiding.

OPENING STATEMENT OF HON. J. BENNETT JOHNSTON, U.S. SENATOR FROM LOUISIANA

The CHAIRMAN. This afternoon is the first of two hearings we have scheduled on the implementation of the United States-Canada Free Trade Agreement and its potential impact on energy and natural resource industries.

This is an important issue which needs very close scrutiny. A free trade agreement appears on the surface to be something almost everyone can support; however, we need to take a close look at it and assess its real impact.

Who benefits from the agreement? Who are the losers? The administration has stated that this is a "win-win" situation, and maybe so; but I tend to get nervous when I hear that everyone is going to be a winner.

The composition of our trade with Canada highlights the potential impact of the Free Trade Agreement on the energy and natural resources sector and leads me to question whether the benefits of the agreement are equally distributed throughout the economy. While United States exports to Canada represent predominantly manufactured goods, close to 50 percent of the leading imports from Canada are various fuels, minerals and forestry products.

Bilateral trade in energy and related products was over $15 billion in 1985, of which imports from Canada were over $12 billion and United States exports to Canada were about $3 billion.

While the concept of pursuing a more open market between the United States and Canada has considerable merit, the relationship in energy trade suggests that the benefits as well as the burdens of a free trade agreement could fall unevenly among domestic industries.

One of the difficulties in getting a firm grasp on the agreement is that legislatively, only two laws are to be amended to implement the energy portion of the agreement. What are the implications of the rest of the agreement? There are still many questions as to what will be the actual effect of the agreement in the energy area.

A primary concern is the treatment of uranium in the agreement which exempts Canada from section 161(v) of the Atomic Energy Act section 161(v) requires the Secretary of Energy to restrict the enrichment of foreign uranium under certain circumstances.

As you are all well aware, S. 2097 as passed by the Senate, imposes a sliding scale of charges for the use by utilities of foreign uranium above specified levels. These charges are completely phased out by January 1, 2001. This legislation is consistent with the phased approach embodied in other areas of the agreement.

I very much hope that the administration will agree with the committee and the Senate that our approach is consistent with the Free Trade Agreement.

I am also concerned with the impact of the agreement on energy regulatory matters. It is important to clarify that the agreement does not in any way affect the ability of the United States to impose terms and conditions on imports and exports of natural gas under the Natural Gas Act.

I look forward to hearing from today's witnesses, the U.S. Trade Representative and the Department of Energy on the administration's view of the effect of the agreement on the energy and natural resources industries of this nation.

Before we hear from our witnesses, I wonder if my colleagues would like to say a word.

Senator Melcher.

Senator **MELCHER**. Mr. Chairman, I have no opening statement. I am just curious as to how we are going to be sure from this agreement that if Canada, as it has in the past occasionally, wanted to flood our markets with natural gas, what is in the agreement to say that that is not a possible policy for them to establish.

I must point out that natural gas is premium, nonrenewable resource. Anytime that gas comes into the country at less than $2, it seems to me to be a great waste, and I would like to have a thorough explanation of why this agreement does not address that problem or, if the Ambassador thinks it does, how he thinks it does address that problem.

Thank you, Mr. Chairman.

The **CHAIRMAN**. Thank you, Senator Melcher.

Senator Bingaman.

STATEMENT OF HON. JEFF BINGAMAN, U.S. SENATOR FROM NEW MEXICO

Senator **BINGAMAN**. Thank you, Mr. Chairman. You have given a good overview of the issues.

There are three activities in my State that I am particularly interested in hearing some testimony on. One is potash. I believe the agreement would not replace current U.S. antidumping laws and would not set aside past rulings on potash dumping. This is important to us. I would like to be sure that this point is established.

I am still concerned about the proposal that any rulings of this type in the future be appealed to the bilateral commission rather than to the U.S. courts, as has previously been the case.

You have talked about uranium and the problems with the repeal of 161(v) of the Atomic Energy Act. That is a concern I have as well.

With regard to Canadian natural gas, the natural gas producers in my State goes mainly to the California market. The Canadian gas, of course, comes into the California market as well and has displaced some of our New Mexican gas.

In this regard, I am especially concerned with the effort of the FTA on FERC opinion 256, the as-billed decision on Candian natural gas. I would like whatever assurances we could get today that FERC 256 would not be changed nor affected by this Free Trade Agreement. We need to make as good a legislative history as we can on that issue, and that is what I hope we can do during this hearing.

Thank you.

[Prepared statements of Senators Bingaman and McClure follow:]

STATEMENT BY SENATOR JEFF BINGAMAN
CANADIAN FREE TRADE AGREEMENT
APRIL 19, 1988

I thank the Chairman for scheduling these two days of hearings to allow the Committee the opportunity to review the Free Trade Agreement as it relates to energy and natural resources. The Agreement is one of the most comprehensive agreements this nation has ever signed, and the implementing language must be reviewed carefully by the Congress.

I am concerned that the Administration has not been sensitive with those of us who have concerns over the energy and national resource provisions of the Agreement.

I am particularly concerned over the issue of Canadian subsidization of natural resource exports to the United States, especially potash, uranium, and natural gas.

POTASH

With regard to potash, I understand the Agreement will not replace current U.S. anti-dumping laws and will not set aside the past ruling on potash dumping.

The pact will, however, set up a bilateral commission for appeals of anti-dumping rulings rather than appeals to U.S. courts. This panel is to be bound by U.S. and Canadian trade law.

URANIUM

I am very concerned with the Agreement's treatment of Canadian energy exports, especially natural gas and uranium.

For example, the Agreement as signed calls for the repeal of section 161(v) of the Atomic Energy Act with respect to the restriction of uranium imports from Canada. Section 161(V) requires the U.S. government to maintain a viable domestic uranium industry. The Senate recently passed the Uranium Revitalization, Tailings Reclamation and Enrichment Act of 1987. I cosponsored an amendment to the bill to replace section 161(v) with a new procedure imposing a sliding scale charge for the use of foreign uranium. Since the legislation includes a 12 year phase out of this charge, similar to the phase out of tariffs under the Canadian FTA, and implements our commitment to repeal section 161(v), I believe this legislation is consistent with the FTA. I hope the House will act quickly on this bill and the President will sign it. This action will eliminate one concern I have over the Canadian FTA.

CANADIAN NATURAL GAS

With respect to natural gas, the primary concentration of Canadian exports go to the California market. New Mexico has been a predominant supplier of natural gas to this market. However, in the past three years, Canadian gas has displaced much of the New Mexico gas. It is clear that this displacement is a result of the Canadians being willing to sell their gas cheaper than our domestic producers are able to. New Mexico producers would suggest that part of this was due to the difference in rate design which the Federal Energy

Regulatory Commission's (FERC Order #256) "as billed" decision attempted to address. I would like assurances today that FERC Order 256 will not be changed nor affected by the Free Trade Agreement. I want the legislative history to be clear on this point.

CONCLUSION

I look forward to discussing these issues with our witnesses today.

OPEN STATEMENT
SENATOR JAMES A. McCLURE (R-ID)
RANKING MINORITY MEMBER
COMMITTEE ON ENERGY AND NATURAL RESOURCES
APRIL, 19, 1988

CANADA-U.S. FREE TRADE AGREEMENT

Good afternoon. I wish to express my appreciation to the Chairman for scheduling these oversight hearings on the Canada-U.S. Free Trade Agreement.

As you are aware, there are some who characterize the Agreement as generally unfavorable to U.S. interests, especially in our energy and natural resources sectors. Even the Canadian's own chief trade negotiator, Simon Reisman, is quoted as saying --

> "The trade covered by the items we eventually agreed to are close to three-to-one in favor of Canada....Our people were way ahead of them in terms of the analysis, the investigation, the facts, the methods, the procedures, the whole business. You would think that the United States was an underdeveloped country alongside us in terms of the way this negotiation went."

During Senate debate on S.2097 I reviewed my concerns regarding the unfair treatment of our uranium industry and I ask unanimous consent that an extract from those remarks appear following my opening statement. My conclusion was that under the Agreement the U. S. surrenders previously established rights to protect its uranium industry for national security or energy needs. At this time, however, I would like to address some of my other concerns.

I am in favor of international agreements that foster competition in international markets and promote free trade, but I question whether this Agreement does in fact promote competition on a fair and equitable basis such that both sides are playing by the same rules of the game.

First, it is clear that both the Canadian federal and provincial governments are committed to programs which, directly and indirectly, subsidize and support Canadian natural resources. Rather than address these subsidies, the Agreement provides for a seven year review of such subsidies. As long as these subsidies continue, I must question whether the agreement fosters competition and free trade.

Second, there is the matter of the dispute mechanism. When disputes arise they are to be referred to a Binational Panel for reconciliation; however, the procedures and mechanism for arbitration are yet to be defined.

Third is the effect of the Agreement on regulatory actions by U.S. Federal and State public service commissions. For example, will disputes regarding decisions by the Federal Energy Regulatory Commission be referred to the Binational Panel for resolution on a different basis than provided for by United States laws?

And, finally, there is the effect of the agreement on the Bonneville Power Administration. I note that the Agreement requires BPA to modify its intertie access policy so as to give B.C. Hydro treatment no less favorable than that shown to U.S. utilities located outside the Pacific Northwest. What this means is unclear and, under the agreement, its interpretation is likely to be made by the Binational Panel. This, in my opinion, would not be appropriate.

These are just some of the concerns that I hope can be answered to my satisfaction by the Administration and the final statutory language. From this perspective I look forward to the Administration's testimony this afternoon. Thank you.

EXTRACT
SENATE REMARKS ON S. 2097
SENATOR JAMES A. McCLURE
MARCH 30, 1987

CANADA-U.S. FREE TRADE AGREEMENT

Before I leave this matter, I feel compelled to reconcile the approach of this amendment to the provisions of upcoming, proposed U.S./Canada Free Trade Agreement.

There are some who would say at the onset that the U.S./Canada Free Trade Agreement is generally unfavorable to U.S. interests, especially in our energy and natural resources sectors. Even the Canadian's own chief trade negotiator, Simon Reisman, is quoted as saying "The trade covered by the items we eventually agreed to are close to three-to-one in favor of Canada....Our people were way ahead of them in terms of the analysis, the investigation, the facts, the methods, the procedures, the whole business. You would think that the United States was an underdeveloped country alongside us in terms of the way this negotiation went." But more importantly, our own National Governors' Association as well as other knowledgeable, concerned parties, have recognized the clear fact that this Agreement treats our uranium industry unfairly.

Rather than reject the uranium provisions of the Agreement out of hand, we propose a compromise that is consistent with other provisions of the Agreement, wherein a phase-out of restrictions is allowed over a period of time. We see this approach taken with respect to many commodities and practices covered under the Agreement, including wine, custom duties, anti-dumping and countervailing duties, investment limitations, automobile embargoes, log export restraints, architects' professional qualifications, and certain tariffs. All we are asking is that this phased approach be extended to uranium. At the same time, our approach does repeal section 161v of the Atomic Energy Act, as the U.S./Canadian Free Trade Agreement would require. So we are not very far off the track with our approach, and we are anxious to speak to this issue now, before the implementing language of the Free Trade Agreement comes forward, by which time it will be too late to speak out on this particular issue.

So, in conclusion, I would ask my colleagues to view our uranium usage requirements under amendment 1465 as being compatible with the intent of the U.S./Canada Free Trade Agreement, and moreover, vital to our national security interests.

The CHAIRMAN. Before hearing from our first witness, let me read into the record a letter just received dated April 18, 1988 from Allan Gotlieb, the Ambassador from Canada, who states as follows:

> Dear Senator Johnston: The Honorable Marcel Masse, Canada's Minister of Energy, Mines and Resources, has asked me to respond to your letter to him of March 28, 1988, in which you ask if it is the Canadian Government's position that, upon approval of the Free Trade Agreement by the United States and Canada, FERC Opinion 256, which is the as-billed decision, is overturned.
>
> The Canadian Government does not view FERC's as-billed decision as being inconsistent with or affected by the Free Trade Agreement. I can assure you that the Canadian government has no plans to use the agreement to overturn FERC's existing as-billed decision; that is, Opinion 256.
>
> The Canadian Government had a series of consultations in 1987 with the Department of Energy on the as-billed decision which provided a useful forum for discussing Canadian concerns and the United States Government's rationale for its support for FERC decisions.
>
> In the event of future regulatory concerns on either side of the border, Article 905 of the agreement provides for similar consultations.
>
> We share the United States administration's view that this provision will be helpful in avoiding future conflicts on regulatory issues.

That is signed by Allan Gotlieb.

So for our first witness, Mr. Yeutter, you might begin by answering whether that is your understanding of our agreement as well.

I would like to welcome Clayton Yeutter, my friend and neighbor and our outstanding U.S. Trade Representative.

Mr. Yeutter.

STATEMENT OF HON. CLAYTON YEUTTER, AMBASSADOR, U.S. TRADE REPRESENTATIVE, ACCOMPANIED BY ROBERT REINSTEIN, DIRECTOR, ENERGY AND NATURAL RESOURCES AND CHARLES ROH, GENERAL COUNSEL'S OFFICE

Ambassador YEUTTER. Thank you, Mr. Chairman. I would rather be out with you enjoying the dogwoods, but I guess we both have to work from time to time, do we not?

The CHAIRMAN. We could shut this down now. [Laughter.]

Ambassador Yeutter. Thank you, Mr. Chairman. It is nice to be with you and the other members of your committee. I have a prepared text, but I would like to do my beginning comments extemporaneously if that would be satisfactory to you.

I would like to introduce the folks who are here with me. As you well know, the gentleman to my right is the Honorable Bill Martin, the Deputy Secretary of Energy, who will have some remarks after I conclude mine. His associate is Scott Campbell.

On my left are my two associates from USTR, Bob Reinstein, who is our Mr. Energy and who is very intimately involved in these negotiations with Canada.

To his left is Mr. Chip Roh from our General Counsel's Office, R-o-h, who is very heavily involved in all of the legal aspects of the agreement and will be able to comment on the issues that you raised earlier.

First of all, Mr. Chairman, I would say in response to one of your comments about whether or not everybody is a winner, assuredly not everybody will be a winner in the United States-Canada agreement or, for that matter, in any other comparable negotiation of this kind. There will be individual firms that will face added competition on both sides of the border as a result of the implementation of this agreement, and obviously industries as a whole will have varied results in terms of their future economic performance based upon the sorting out of this agreement over a period of time.

When one looks at it in the aggregate, Mr. Chairman, there should be no doubt about the fact that both countries will be winners. That is the ultimate decision to be made here.

From our standpoint, the question is whether or not the United States as a nation will be better off with or without the agreement. In my judgment, that is an easy question to answer. We will clearly be substantially better off with it. Obviously, our Canadian colleagues will have to ask and answer the same question. In my judgment, Canada will clearly be better off with it than without it.

It is a fortunate situation in the sense that this is not a zero sum game and that both countries clearly can be winners.

I am not going to go into the details of how that will happen because a lot of that is beyond the scope or interest of this particular committee, and I do not want to use all our time this afternoon doing that. It clearly should be evident to all of us that there are major benefits to be gained from implementation of the agreement.

Now, to bring that down into the energy area which is of primary interest to you and your committee, Mr. Chairman, the magnitude of energy trade between the two countries is already substantial, as you know, well over $10 billion. Canada is our largest supplier of crude oil, 800,000 barrels per day thereabouts; almost all of our imported natural gas and electricity; the majority of our imported uranium.

Going in the other direction, Canada is our largest export market for coal. So that activity is substantial and is likely to continue to grow over time whether or not we have a free trade arrangement.

Since energy trade between the two countries is already relatively free, in fact, for all practical purposes totally free, we are not going to see the immediate impacts on trade in this area as we will in a good many areas where there are more impediments to products and services moving between the two borders. In those other areas, we believe there will be a very substantial increase in economic activity between the two countries.

Now, let me then go on to say that, in my judgment, among the major benefits to the United States in this agreement will be the benefits on the energy side. Now, clearly one has to distinguish between looking at this from a viewpoint of an energy producer and looking at it from the viewpoint of an energy user. I will comment on the producer side of it in a moment, but if I can switch over and comment a bit on the user side for just a second.

I hope that we will all recognize that energy is a very important component in our manufacturing processes here in the United States, and to the degree that we can achieve greater security of access to energy supplies in Canada than we have today, that is a net plus and should be a very major financial net plus over time to all of the manufacturers of this country that use energy. That is essentially every manufacturing entity in the country.

Obviously there are benefits to consumers, too, when they can rely on a secure access of energy sources from a neighbor next door and do not have to be dependent upon the idiosyncracies of the Middle Eastern market as we do very heavily today. The experience of the last couple of days ought to indicate the merits of that kind of diversification.

One of your House colleagues, Mr. Chairman, said to me at a hearing a month or so ago that, in his view, when we look back on this agreement 50 years from now, we will probably conclude that the area of the agreement of greatest importance and greatest value to the United States was this one, and I suspect he is right.

When one looks at the access question 50 years from now, I suspect that we will say that the security of access that we are assured in this agreement, coupled with assurances of no price discrimination on energy coming into the United States ever again in the future, those two elements alone make this agreement worthwhile totally aside from anything that we experience in other areas of the FTA.

That is really the heart of the energy agreement from the standpoint of the United States: security of access which we will now have hopefully forever more, and security of nondiscrimination in pricing provisions which we will hopefully also have now forever more.

What is the downside risk on the producers' side? We have heard a number of concerns from members of this committee and others about what the agreement may do in this area. I would like to just comment on three or four aspects of that and then ask Bill to make whatever supplemental comments he might wish to make.

First of all, there are comments with respect to subsidies in this area and in other areas of the agreement. The general comment has been why does this agreement not encompass far greater discipline on subsidies and preferably the phaseout of subsidies on both sides of the border.

It would be highly desirable if it were to do so. In fact, we negotiated for a substantial period of time on that issue. But the price to be paid in order to achieve discipline on Canadian subsidies was a major change in our countervailing duty laws in the United States, and we simply, Mr. Chairman, were not prepared or willing to pay that price. We believe we made the right decision.

This is not to say, however, that we are going to forget about this issue and put it on the back burner because we are not. We will have two opportunities in the very near future to continue to work on subsidy programs in the energy area and anywhere else, for that matter.

One is in the followup to the approval of this agreement in which, as you know, we have mutually agreed to have subsidy discussions and negotiations as this agreement unfolds. So we will do it on a bilateral basis with our Canadian friends just as soon as we get this exercise out of the way and can begin to sit down and talk to Canadian government representatives again on the subsidy issue.

The second opportunity is in the Uruguay Round of multilateral negotiations, where we will do it in conjunction with our other trading partners on issues like agriculture as contrasted to energy. That is the proper forum. It does not do much good to try to negotiate bilaterally in agriculture because it is a global problem. The right way to deal with agricultural subsidy distortions is in the Uruguay Round. So that is what will be ahead of us on subsidies.

In the meantime, we have continued use of our countervailing duty laws. I know there is some thought here that the change that was made in this binational panel might alter the application of our countervailing duty laws, but I do not agree with that at all, and we will have an opportunity to elaborate on that later if you wish.

The same argument applies to dumping laws. This gets into the potash question that Senator Bingaman asked about. That particular case that we have had with Canada, Senator Bingaman, on potash will not in any way be changed by the agreement, and the laws themselves will continue to operate just as they are today.

So the only change at all in the antidumping area, again, is the application of the binational commission, and we can comment on that a little more later if you wish. The basic protections going both ways on dumping and subsidization continue as of today.

The other point I would make relating to fair competition, which gets into the uranium issue about which many of you have concerns, is that we have still full use of what is called section 201, our escape clause provisions of the Trade Act, in areas where we simply are not competitive. If the uranium industry or any other industry can build a successful escape clause case, that is available to them.

The fourth provision that is applicable in this area, Mr. Chairman, relates to national security. The national security exemption proposal is fairly tight but, nevertheless, it is there.

Summarizing then, Mr. Chairman, I would simply say that I really believe there are ample protections in the proposal plus the existing laws to properly protect the interests of our producers, whomever they may be, in the energy area. Clearly, there are major benefits to consumers of energy, whether they be manufacturing firms or household consumers, to make this a most worthwhile agreement.

That is all the preliminary comments I have, Mr. Chairman. I would like to ask Bill Martin to add in whatever way he might wish.

[The prepared statement of Ambassador Yeutter follows:]

TESTIMONY OF
AMBASSADOR CLAYTON YEUTTER
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
APRIL 19, 1988

Thank you for the opportunity to testify before you today on the U.S.-Canada Free Trade Agreement.

The formal signing of the Free Trade Agreement on January 2 by President Reagan and Prime Minister Mulroney culminated almost two years of complex, and sometimes difficult negotiations. This Agreement will substantially increase trade and investment opportunities in both the U.S. and Canada. As President Reagan said, "This historic Agreement will strengthen both our economies and over time create thousands of jobs in both countries."

Trade between the United States and Canada too often is taken for granted. Our trade problems with Japan and the European Community are so much in the spotlight that most Americans still don't realize Canada is our biggest trading partner. Yet over $130 billion in goods cross our common border annually. With $60 billion in U.S. exports to Canada in 1987, Canada is also our largest and fastest growing export market.

Canada and the United States also share the world's largest bilateral energy trade relationship, about $10 billion a year in two-way trade. Canada is our largest supplier of crude oil and refined products, over 800 thousand barrels per day, exceeding imports from such countries as Mexico, Venezuela and Saudi Arabia. Canada supplies almost all our imports of natural gas and electricity, and the overwhelming majority of our uranium imports. And Canada is our largest coal export market. This trade is clear important to both countries.

These negotiations were characterized by hard bargaining and difficult compromises. Many will seek to identify winners and losers, but that approach is too narrow. This is a win-win Agreement. It should result in increased economic activity, higher trade levels, more jobs, and enhanced competitiveness for both the United States and Canada. The people of both countries will benefit from this Agreement, through lower prices and greater consumer choice.

The U.S.-Canada Free Trade Agreement is the most comprehensive bilateral trade agreement ever negotiated. As the world's largest trading partners we are constructing the world's largest shared market. We have submitted to the Subcommittee today an extensive summary of the Agreement. Therefore, in my formal statement I will only highlight its main provisions.

Under the Agreement, we have eliminated all tariffs between the United States and Canada, without exceptions. Since Canadian tariffs are, on average, twice as high as comparable U.S. rates, total tariff elimination will provide significant benefits for the U.S. exporter.

For the first time since services became a major international commercial issue, two major trading partners have negotiated an agreement establishing rules for bilateral trade in services. These rules will cover over 150 service sectors, such as construction, telecommunications network-based enhanced services and computer services, architecture, accounting, tourism, insurance, and engineering. Not only is this important for U.S.-Canada services trade, but it provides a concrete first step for our efforts to formulate multilateral rules for services at the GATT Uruguay Round. We also concluded the first bilateral agreement with any other country covering the financial sector.

We are establishing much freer and more secure trade in energy. The Agreement calls for nondiscriminatory access for the United States to Canadian energy supplies and secure market access for Canadian energy exports to the United States. Our approach is market-oriented. Under the FTA the Canadian Government will not be able to impose higher prices on us than they charge Canadians. Cheaper and more secure energy supplies will make U.S. industries more competitive, both in North America and throughout the world.

Also for the first time, the United States and Canada have agreed to rules governing bilateral investment activities. The Agreement reduces the screening of U.S. investment in Canada, and moves Canada towards a more open, market-oriented investment environment.

The question of how to apply countervailing duty and antidumping laws was one of the most difficult to settle. We finally agreed to retain existing national laws and procedures dealing with subsidies and dumping. But final decisions taken under those laws may be appealed to binational dispute settlement panels upon the request of either party.

There are also provisions covering automotive trade, agriculture, alcoholic beverages, customs matters, government procurement, product standards, personnel movement, and many other areas. These are all described in detail in the summary we submitted to the Subcommittee today.

I know that the Subcommittee is particularly interested in the impact of the FTA on our energy sector so I will focus for a few moments on that important area.

Energy is a "win-win" deal in this agreement. Canada wins because it gets assured access to the world's biggest energy market and the U.S. wins because we get assured, nondiscriminatory access to a major source of energy supplies, which we will need increasingly in the 1990's and beyond. Without this kind of formal assurance to buyers and sellers in both countries that the governments will by and large keep their hands off the energy trade over the longer term, major energy resources, such as those in Canada's Arctic areas, are unlikely to be developed in the most economically efficient way. By encouraging the most efficient development of North American energy resources, the FTA will enhance the energy security and international industrial competitiveness of both countries. That's clearly "win-win."

Energy trade between the U.S. and Canada is essentially free today, with minimal tariff levels on oil and none on other energy commodities. I don't understand why, then, some are claiming that the FTA will result in a significant surge of imports from Canada? Also, there are some claiming that the FTA makes them vulnerable to subsidized competition from Canada. I just don't see that. All U.S. trade laws have been left intact by the FTA, so unfair imports can be addressed just as they are today.

On energy investment, we locked Canada in to the current investment regime, which is far more liberal than the restrictive policies of the previous government, and obtained further liberalization in some areas beyond the current situation. I believe we may see further progress in the future when Canada begins to consider the capital requirements for the energy megaprojects that will need to be developed for both countries to take full advantage of the continental energy market created by the FTA energy provisions.

From an energy policy perspective, the FTA represents a logical continuation of the free-market approach we have been pursuing in the domestic market since 1981. It extends that approach to our trade with our largest and closest energy trade partner, and enshrines the principle of nonintervention by governments for the long term, to the clear benefit of present and future producers and consumers in both countries.

The proposed Agreement spans many sectors of our economies. We expect numerous industries and groups to mobilize strong support. Nonetheless, we recognize that, despite widespread enthusiasm for this Agreement, some may disagree. For some, there may be too much free trade in this Free Trade Agreement. Some special interests will see themselves as vulnerable to increased competition in a free trade area. Others may be timid, afraid to try a creative approach to the future, fearful of the unknown, thinking that no change means no risk. Yet in this dynamic, interdependent world of ours, the future inevitably holds risks, and the status quo is never sustainable. To do nothing is to retrogress.

Then there are those who are disappointed because they wanted more and wanted it now. Unfortunately, some entered these negotiations with unrealistic expectations that the negotiations would cure all their ills. This Agreement is *not* a panacea for every ill. It will reduce, but not end, trade frictions. It will minimize, but not eliminate, trade distortions. There never has been, and likely never will be, perfectly free trade between any two independent sovereign countries. This Agreement was never intended to solve all our bilateral trade problems and should not be expected to do so. By establishing dispute resolution and consultation mechanisms, the agreement explicitly recognizes this fact. It is a vast improvement over the prevailing situation, and a bold step toward significantly freer trade between our countries. It is a massive advancement over the status quo.

The question on both sides of the border should be "will this Agreement make my country a better and more prosperous place to live a decade or a half century from now?" The objective answer to that question will be a resounding *yes*!

We must keep our eyes squarely on the long-range benefits for each nation as a whole. This Agreement will help both Americans and Canadians enter the 21st century more competitive and better prepared for the future.

We should approve this Agreement and then build on it in the future. It will, without doubt, be the most significant bilateral trade agreement either country has ever negotiated.

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

SUMMARY OF
THE U.S.-CANADA FREE TRADE AGREEMENT

February 1988

TABLE OF CONTENTS

Statement by the President..............................3

White House Fact Sheet..................................5

Brief Summary of Key FTA Provisions.....................8

Summary of the Agreement................................10
- Preamble...10
- Part One: Objectives and Scope.........................10
  - Chapter One: Objectives and Scope.....................10
  - Chapter Two: General Definitions......................10
- Part Two: Trade in Goods...............................11
  - Chapter Three: Rules of Origin for Goods..............11
  - Chapter Four: Border Measures.........................12
  - Chapter Five: National Treatment......................15
  - Chapter Six: Technical Barriers.......................15
  - Chapter Seven: Agriculture............................17
  - Chapter Eight: Wine and Distilled Spirits.............19
  - Chapter Nine: Energy..................................21
  - Chapter Ten: Trade in Automotive Goods................23
  - Chapter Eleven: Emergency Action......................25
  - Chapter Twelve: Exceptions for Trade in Goods.........26
- Part Three: Government Procurement.....................27
  - Chapter Thirteen: Government Procurement..............27
- Part Four: Services, Investment and Temporary Entry....28
  - Chapter Fourteen: Services............................28
  - Chapter Fifteen: Temporary Entry for Business Persons.29
  - Chapter Sixteen: Investment...........................31
- Part Five: Financial Services..........................33
  - Chapter Seventeen: Financial Services.................33
- Part Six: Institutional Provisions.....................35
  - Chapter Eighteen: Institutional Provisions............35
  - Chapter Nineteen: Binational Dispute Settlement in Antidumping and Countervailing Duty Cases.....36
- Part Seven: Other Provisions...........................38
  - Chapter Twenty: Other Provisions......................38
- Part Eight: Final Provisions...........................39
  - Chapter Twenty-One: Final Provisions..................39

For Further Information....................................40

THE WHITE HOUSE

Office of the Press Secretary
(Palm Springs, California)

January 2, 1988

STATEMENT BY THE PRESIDENT

I am pleased to announce that Prime Minister Mulroney and I have today entered into an agreement to establish a free trade arrangement between the United States and Canada.

In the truest sense, this is an historic agreement for both sides. We will strengthen what is already a deep friendship between our people by enhancing economic opportunities and creating jobs in both countries. Moreover, the agreement firmly establishes that the trade environment between the two countries will in the future be founded on the principle of free and open trade.

This comprehensive agreement will benefit many sectors of the U.S. economy. Canadian and American tariffs will be phased out completely, saving consumers hundreds of millions of dollars while also improving our export opportunities. It will secure access to Canada's market for American manufacturing, agriculture, financial services, and high technology; improve national security through energy sharing; and provide important investment opportunities. Canada will benefit from the agreement in many of these same ways; the pact is truly reciprocal. As the agreement goes into effect, Canada's access to our large domestic market will grow, and Canadian industrial centers will gain opportunities to develop even more important roles in the economy of North America.

The agreement to establish a free trade area has important international implications as well. It will encourage supporters of free trade throughout the world by demonstrating that governments can remove trade barriers even in the face of protectionist pressures. We hope that the U.S.-Canada example will help set the tone for the Uruguay Round multilateral trade negotiations.

Our negotiations with the Canadian government leading to this agreement incorporated advice from Congress, industry, agriculture, and labor. Our Congress, as well as the Canadian Parliament, will review the agreement fully over the next several months. As this process begins, both sides should be mindful that the decisions they make will help shape the relationship between our

MORE

countries in the years to come, and will send a signal to the rest of the world.

The creation of the world's largest free trade area will be a mark of leadership and presents an historic opportunity to the United States and Canada. We must not let this opportunity slip from our grasp.

# # #

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release January 2, 1988

FACT SHEET

U.S.-CANADA FREE TRADE AGREEMENT

The United States and Canada have entered into a free trade agreement that, if approved and implemented, will take effect on January 1, 1989. The agreement will:

- Eliminate all tariffs on bilateral goods trade within 10 years of implementation;
- Reduce nontariff trade barriers;
- Establish principles for the conduct of bilateral trade in services;
- Establish rules for the conduct of bilateral investment;
- Resolve many outstanding bilateral trade issues;
- Enhance the energy and national security of the two countries;
- Facilitate business travel; and
- Establish a timely bilateral dispute settlement mechanism.

Economic Implications

Each year the U.S. and Canada exchange more goods and services than any two countries in the world. Bilateral trade in goods and services exceeded $150 billion in 1986.

The elimination of tariffs and most other barriers to trade between the two countries will increase economic growth, lower prices, expand employment and enhance the competitiveness of both countries in the world marketplace.

Chronology of the Negotiation

- In March 1985, President Reagan and Prime Minister Mulroney asked their trade officials to explore ways to reduce and

MORE

eliminate existing barriers to trade between the U.S. and Canada.

- On September 26, 1985, Prime Minister Mulroney formally requested that the U.S. and Canada examine the potential for negotiating a comprehensive free trade agreement.
- On December 10, 1985, President Reagan notified the Congress of his intent to enter into bilateral negotiations with Canada using "fast track" procedures.
- On June 17, 1986, U.S. and Canadian negotiators on the free trade area met for the first time in Ottawa.
- On October 3, 1987, President Reagan notified Congress of his intent to enter into a free trade agreement with Canada.
- On December 9, 1987, U.S. and Canadian negotiators initialled a final text of the agreement.
- On January 2, 1988, President Reagan and Prime Minister Mulroney signed the final text of the agreement.

The Fast Track

Section 102 of the Trade Act of 1974 authorizes the President to enter into bilateral free trade agreements and to have the Congress approve them on a "fast track" basis. Section 102 authority expires at midnight on January 2, 1988.

In order for a bilateral agreement to qualify for fast track consideration, several conditions must be met:

- The negotiation must be requested by the foreign country;
- The President must notify the House Ways and Means and Senate Finance Committees of the negotiations, giving them 60 legislative days advance notice:
- The President must notify the Congress of his intent to enter into an agreement 90 days before doing so.

After entering into an agreement, the President must submit it to Congress, along with a draft implementing bill, a statement of any administrative action proposed to implement the agreement, an explanation of how the bill or statement changes or affects existing law and a statement of reasons why the agreement serves the interests of U.S. commerce and why the bill and proposed action are required and appropriate.

MORE

The implementing bill is introduced in both Houses of Congress on the day it is submitted and is referred to the committees of jurisdiction. House committees have 45 days in which the House is in session to report the bill; they are discharged automatically from further consideration after that period. The House votes within 15 days in session after the measure has been received from the House committees.

After receiving the bill from the House, the Senate committees have 15 days in which the Senate is in session to report the bill; they are discharged automatically from further consideration after that period. The Senate votes within 15 days in session after the measure has been received from the Senate committees.

Amendments to the bill are not in order. A simple majority of each House is required for approval.

# # #

BRIEF SUMMARY OF KEY FTA PROVISIONS

- Tariffs: Eliminates all tariffs on U.S. and Canadian goods by 1998.

- Rule of origin: Uses a rule of origin to prevent third country goods from receiving FTA tariff treatment.

- Customs: Ends customs user fees for goods and duty drawback programs by 1994 for bilateral trade and duty waivers linked to performance requirements by 1998 (except for the Auto Pact).

- Quotas: Eliminates import and export quotas unless allowed by the GATT or grandfathered by the FTA.

- National treatment: Reaffirms GATT principle preventing discrimination against imported goods.

- Standards: Prohibits use of product standards as a trade barrier and provides for national treatment of testing labs and certification bodies.

- Agriculture: Eliminates all bilateral tariffs and export subsidies and limits or eliminates quantitative restrictions on some products, including meat. Eliminates Canadian import licenses for wheat, oats and barley when U.S. crop price supports are equal or less than those in Canada.

- Wine and Distilled Spirits: Removes most discriminatory practices against wine or spirits imported from the other country.

- Energy: Prohibits most import and export restrictions on energy goods, including minimum export prices. Requires any export quotas used to enforce short supply or conservation measures to share resources proportionately. Provides for Alaskan oil exports of up to 50,000 barrels per day to Canada.

- Autos: Replaces and Canadian content rule for duty-free Auto Pact imports into the U.S. with tougher FTA content rule. (Most auto trade already is duty-free under the U.S.-Canada Auto Pact.) Does not change rules for Auto Pact-qualified companies importing duty-free into Canada, but does not allow new companies to qualify. Permits U.S. auto and parts exports that meet the FTA rule to enter Canada at FTA tariff rates, which phase out over 10 years. Ends all Canadian duty remission programs for autos by 1998.

- Emergency action: Allows temporary import restrictions to protect domestic industries harmed by imports from the other country in limited circumstances.

- Government procurement: Expands the size of government procurement markets that will be open to suppliers from the other country.
- Services: Commits governments not to discriminate against covered service providers of the other country when making future laws or regulations. (Exempts transportation services.)
- Temporary Visas: Facilitates travel for business visitors, investors, traders, professionals and executives transferred intra-company.
- Investment: Provides national treatment for establishment, acquisition, sale and conduct and operation of businesses. (Exempts transportation.) Commits Canada to end review of indirect acquisitions and to raise to C$150 million (in constant 1992 Canadian dollars) the threshold for review of direct acquisitions. Bans imposition of most investment performance requirements.
- Financial Services: Exempts U.S. bank subsidiaries in Canada from Canada's 16 percent ceiling on assets of foreign banks. Ends Canada's foreign ownership restriction on U.S. purchases of shares in federally regulated insurance and trust companies. Reviews U.S. firms' applications for entry into Canadian financial markets on the same basis as Canadian firms' applications. Permits banks in the U.S. to underwrite and deal in debt securities fully backed by the Government of Canada or political subdivisions. Guarantees continuation of multi-state branches of Canadian banks.
- General dispute settlement (except for financial services and countervailing duty and antidumping duty cases): Establishes a binational commission to resolve disagreements.
- CVD/AD dispute settlement (for countervailing and antidumping duties): Allows countries to continue to apply existing national laws. Replaces court review with a binational panel (when requested), which must apply national law in rendering decisions under international law.
- Softwood lumber: Preserves the 1986 agreement with Canada on provincial pricing practices.
- Culture: Exempts cultural industries from the FTA, but authorizes measures of equivalent commercial effect in response to actions otherwise inconsistent with the FTA.

SUMMARY OF THE AGREEMENT

Preamble

The Preamble to the Agreement describes the two countries' desire to improve their economies, to achieve full employment and increase living standards and to strengthen the competitiveness of both countries' firms in the global marketplace.

PART ONE: OBJECTIVES AND SCOPE

The first part includes chapters setting out the objectives and scope of the Agreement and defining key terms.

Chapter One: Objectives and Scope

The Agreement establishes a free trade area (FTA) consistent with the General Agreement on Tariffs and Trade (GATT), the multilateral agreement governing trade relations between 94 countries.

The objectives of the Agreement are to:

- eliminate barriers to trade in goods and services between the two countries;
- facilitate conditions of fair competition;
- significantly liberalize conditions for investment;
- establish effective procedures to administer the Agreement and resolve disputes;
- and lay the foundation for further bilateral and multilateral cooperation.

The federal governments agree to ensure that state, provincial and local governments take necessary actions in areas under their jurisdiction to implement the Agreement. They establish that the Agreement generally will take precedence over pre-existing agreements, except where specified, and they agree to treat each other's goods, services and investment as they treat their own to the extent provided in the Agreement.

Chapter Two: General Definitions

Words critical to the application of the Agreement are defined.

PART TWO: TRADE IN GOODS

Chapters three through twelve deal with trade in goods, building on the GATT and other agreements. Chapters three through six, eleven and twelve apply to all trade in goods. Chapters seven through ten apply to individual sectors.

Chapter Three: Rules of Origin for Goods

The Agreement will eliminate all tariffs between the U.S. and Canada, but each country will maintain its own tariffs on imports from other countries. Because of the disparities between U.S. and Canadian tariff levels, it is necessary to prevent imports from third countries from being shipped through one FTA partner into the other in order to escape the higher tariff.

Rules of origin are used to define those goods entitled to duty free treatment. Goods wholly produced in either the U.S. or Canada will qualify for FTA treatment. Goods containing imported inputs will qualify if they are processed enough to result in one of several specified changes in tariff classification under the internationally agreed Harmonized System; that is, they must be changed in ways that are physically and commercially significant. In some cases, there is the explicit requirement that at least half of the cost of manufacturing the goods must be attributable to Canadian and/or American materials and/or direct costs of processing. Finally, there is a safeguard provision denying FTA treatment to any goods altered merely to circumvent the rules of origin.

Goods that are further processed in a third country before being shipped to their final destination will not qualify for FTA treatment. For example, goods produced by either U.S.- or Canadian-owned maquiladora operations in Mexico will not qualify.

Apparel made from fabric woven in the U.S. or Canada will be duty-free but apparel made from imported fabric will qualify for FTA treatment only up to the following levels:

	Non-Woolen Apparel	Woolen Apparel
	(in million-square-yard equivalent)	
Imports from Canada	50	6
Imports from the U.S.	10.5	1.1

Non-woolen fabric and made-up textile articles, woven or knitted in Canada from yarn produced or obtained in a third country, will qualify for FTA treatment for three years, but only up to an annual level of 30 million square yards.

The two governments will consult regularly to ensure that the rules of origin are operating effectively and to consider changes to the rules where experience suggests changes may be helpful.

Chapter Four: Border Measures

The central element of a free trade area is the elimination of substantially all tariff and nontariff trade barriers.

Tariffs

All bilateral tariffs will be eliminated in stages by January 1, 1998. The removal of tariffs will increase two-way trade and lower costs to consumers in both countries, thereby creating a single U.S.-Canadian market of 265 million people. Approximately 75 percent of bilateral merchandise trade, currently in excess of $120 billion, already moves free of duty. The remaining 25 percent, however, is subject to tariffs. Canadian tariffs average about 9-10 percent, or about twice the U.S. average of approximately 4-5 percent.

The results of the tariff negotiation are expressed in terms of the new Harmonized System (HS) of tariff nomenclature. (If either country fails to adopt the HS, duties will be eliminated by converting the schedule of reductions back to current tariff schedules.) All dutiable products in the HS were assigned to one of the following three staging categories: (1) immediate elimination; (2) five equal, annual cuts (20 percent per year), and (3) ten equal, annual cuts (10 percent per year). In almost all instances, staging on a particular product is the same in both countries. The stages for various commodities were selected in recognition of the fact that industries in both countries will require varying periods of adjustment to changing competitive conditions.

Import-sensitive industries on both sides of the border were generally accorded 10-year staging, which would result in the duty being eliminated by January 1, 1998. These include plastics, rubber, most wood products, lead, zinc, base metal articles, footwear, textiles and apparel, steel, many alcoholic beverages, consumer appliances, precision instruments, watches and most agricultural and fish products.

Immediate duty elimination is scheduled for such products as automatic data processing and related equipment, certain telecommunications equipment, motorcycles, whiskey and rum, some processed fish, raw hides, leather and furs.

All other duties will be phased out by January 1, 1993. Included within this category are paper, furniture, printed matter, chemicals, after-market automotive parts, precious jewelry, most machines, some musical instruments, and petroleum.

The Agreement provides that tariffs can be reduced faster whenever the two governments agree.

Customs Programs and Procedures

The Agreement eliminates duty drawback for bilateral trade, duty waivers linked to performance requirements (except as provided in the chapter on automotive trade), and the U.S. customs user fee for Canadian merchandise. It authorizes importers and exporters to certify that goods meet the rules set out in the rules of origin chapter and are therefore eligible for FTA tariff treatment. These measures are intended to prevent imports from third countries from benefiting from the FTA.

Duty Drawback: Both countries will end duty drawback on exports to the other as of January 1, 1994, with limited exceptions. Most countries, including the United States and Canada, have duty drawback programs, which provide for the return of duties on imports when they or substituted domestic goods are incorporated in goods subsequently exported. Because of the elimination of bilateral tariffs, continuation of duty drawback between the two parties would allow duty free-entry of third-country imports through the other FTA party and would distort trade and investment decisions.

As an exception to the ban on duty drawback for bilateral trade, the following goods will continue to benefit from the program:

- goods remaining in the same condition on exportation as on importation (but they would not benefit from FTA tariff treatment),

- dutiable goods of the United States or Canada if they are incorporated into, or directly consumed in, the production of goods subsequently exported back to the FTA partner, and

- goods where both parties agree to maintain duty drawback (this category consists of (1) imported citrus products and (2) fabric imported from a third country and made into apparel that is subject to the most-favored-nation (MFN) tariff when exported to the other party).

Also, beginning January 1, 1994, goods withdrawn from a Foreign Trade Zone (FTZ) or benefiting from a similar program will be treated the same whether destined for consumption in the U.S. or Canada. For a good made in a U.S. FTZ, duty must be paid on the value of any foreign components at either the component or the finished-good tariff rate. Maintaining the full benefits of these programs, like duty drawback programs, would have allowed imports from third countries to enter duty-free through the other FTA party and would distort trade and investment.

Duty Waiver: Neither party will introduce new duty waivers or expand existing ones linked to performance requirements after the later of June 30, 1988 or the date of Congressional approval of the Agreement. Existing programs will be eliminated by January 1, 1998. This provision ends the trade-distorting practice of requiring a firm to buy local inputs or to export output in exchange for a tariff exemption.

The 1998 termination date excludes certain waivers affecting automotive trade, as specified in the section on automotive trade. The countries reserve existing rights under other agreements with respect to the Auto Pact or comparable arrangements. This provision maintains the U.S. right to challenge Canadian performance requirements under GATT rules.

If a party can show that a duty waiver to a specific firm granted on a commercial good hurts its commercial interests, then the party granting this waiver must either make it generally available to any importer or end the program. This provision prevents discrimination among firms.

Customs Fees: Starting on January 1, 1990, the U.S. must cut by 20 percent each year the customs user fee on goods qualifying under the rule of origin of the FTA. The fee on Canadian goods will be eliminated as of January 1, 1994. Neither country may introduce new customs user fee programs to pay for the costs of Customs administration on goods from the other country.

Customs Procedures: The Agreement authorizes the governments to require importers to submit a written declaration of origin based on a written declaration of origin provided by the exporter. It requires each country to make it unlawful for the exporter to provide a false certification. False declarations by either the importer or the exporter could be prosecuted by the government of the country in which the offending business is located. This provision will help avoid fraudulent claims of FTA origin to avoid tariffs.

The Agreement also provides for cooperation on enforcement, consultations on uniform application of the rule of origin, review and appeal procedures for decisions on the rule of origin and consultations on major changes affecting customs administration.

Import and Export Restrictions

Import and export quotas and other restrictions can distort trade flows. The elimination of such barriers is essential to an effective free trade area. Unless specifically grandfathered by the Agreement or allowed by the GATT, existing quantitative restrictions will be eliminated immediately or according to a timetable. Some specified restrictions that have been exempt from GATT obligations will be eliminated for trade between the U.S. and Canada.

In all cases where quantitative restrictions are prohibited under the Agreement, use of minimum export prices and minimum import prices (except those used to enforce countervailing duty and antidumping orders) also are prohibited.

Where either country prohibits imports from a third country, it may similarly prohibit the pass-through of imports from that country through the FTA partner. This provision preserves the right to enforce embargoes for foreign policy or other reasons (e.g., embargoes against Cuba or Iran).

Export taxes will not be permitted under the Agreement unless the tax is also levied on goods destined for domestic consumption. In addition, where GATT-permitted export restrictions are applied (such as in the event of a short-supply emergency), the restriction must not reduce the proportion of the good that was exported to the FTA partner relative to the total supply of the good prior to the restriction.

Chapter Five: National Treatment

The Agreement incorporates the GATT requirement that, once imported into either country from the other, goods will not be the object of discrimination. This ensures that the elimination of border measures will not simply be replaced by internal measures favoring domestic goods over imports. This rules out higher sales or excise taxes or regulatory requirements on imports. Discrimination against goods from the other country by provinces or states is prohibited even if a province or a state discriminates against goods from other provinces or states.

Chapter Six: Technical Barriers

There are legitimate public policy objectives for which technical regulations and standards are maintained (e.g., to protect human, animal or plant life or health; to preserve the environment; and to protect essential security interests). However, standards measures may work to inhibit trade.

The Agreement builds on current obligations under the GATT Standards Code not to use standards to hinder trade unnecessarily. Certification and testing facilities will receive nondiscriminatory treatment in both countries. We also agree to work to harmonize our standards where appropriate so that similar products do not have to be made or work in different ways in order to be sold in the other country. Provisions of this chapter do not apply to agricultural goods, which are covered in the chapter on agriculture.

These provisions do not mean that the U.S. will have to adopt the metric system or Canadian standards, or that standards cannot be adopted for legitimate regulatory reasons. The basic rule remains that standards must not create unnecessary obstacles to trade. Obstacles to trade are not created where the demonstrable purpose of standards-related measures is to protect health and safety, environmental, national security and consumer interests. However, such measures must not operate to exclude goods of the other country if they meet these objectives.

Both countries will assure that testing facilities and certification bodies are treated in a nondiscriminatory manner. This paves the way for the recognition by Canadian authorities of U.S. facilities and bodies. This does not require that all testing labs receive accreditation, especially if an individual lab is not qualified in the view of the accrediting authority, but forbids the discrimination against labs on the basis of nationality.

Canada and the United States agree to harmonize (make compatible) federal standards-related measures to the greatest extent possible, and to promote harmonization of private standards. The Agreement does not require that standards and technical regulations be harmonized but provides for it where appropriate. State and private standards-setting bodies are not obligated under any of these provisions.

Both countries will provide for enhanced transparency in the regulatory process. To this end, we will expand our information exchange and guarantee a 60-day comment period on proposed standards-related regulations at all levels. This is important to manufacturers because they need to know about regulatory changes which may affect their products so that they can prepare for the changes, and have some say in them. Similar provisions will apply for state, provincial, and private standards activities at a "best efforts" level.

Processes and production methods are included as standards-related measures subject to the provisions of the Agreement. This provision makes clear that specifying how a product is made is just as much a standards-related measure, and subject to the rules of this section, as specifying how the product should perform.

Both countries will recognize each other's systems for accrediting testing labs. Currently, this is a small program operated by the National Bureau of Standards in the U.S. and the

Canadian Standards Association in Canada to accredit testing labs. Labs accredited under one program will automatically receive recognition in the other country.

Chapter Seven: Agriculture

The U.S. and Canada agree that the achievement of our major trade objectives for our agricultural sectors will require multilateral solutions and accordingly will work together in the Uruguay Round and other fora to liberalize agricultural trade. Nevertheless, the FTA includes provisions providing U.S. and Canadian agricultural producers increased opportunities to market their products in the future with no tariff barriers and with fewer nontariff barriers.

Various barriers to trade in agriculture have arisen in recent years in an attempt to stabilize the agricultural economy. Quotas, import licenses, technical requirements and subsidies have all had a negative effect on trade in agricultural products. The Agreement provides for a number of liberalizing measures in an era of increasing protectionism.

The Agreement provides for semi-annual consultations between the U.S. and Canada on agricultural issues. It also provides that each country shall retain its rights and obligations under the GATT except as otherwise provided.

Tariffs

All agricultural tariffs between the U.S. and Canada will be eliminated within 10 years, thereby facilitating trade and leading to higher efficiency. The agricultural sectors likely to be most affected by the tariff elimination will be fresh fruits and vegetables because some of the highest agricultural tariffs are applied on those products.

Both countries will reserve the right, for 20 years, to apply a temporary duty on designated fresh fruits and vegetables to protect their domestic producers from import surges from the other country. This provision will facilitate a smooth transition to a tariff-free border for both countries, providing a mechanism to prevent unnecessary hardship to fruit and vegetable producers. The temporary duty can only be triggered if (1) the import price falls below 90 percent of the previous five-year average monthly import price for five consecutive days, and (2) the planted acreage in the importing country is not higher than the previous five-year average for the particular fruit or vegetable. The total duty applied under this provision cannot cause the total duty on these products to exceed the lesser of the most-favored-nation (MFN) duty that was in effect for the corresponding season prior to the Agreement or the then current MFN duty. Moreover, it can be applied only once per year per product for no longer than 180 days. The temporary duty will be removed immediately once the import price exceeds 90 percent of the five-year average for five consecutive days.

Subsidies

The U.S. and Canada have agreed to work together to achieve, on a global basis, the elimination of all subsidies which distort agricultural trade through multilateral negotiations such as the Uruguay Round. This is consistent with the U.S. proposal for agriculture in the Uruguay Round. The FTA partners have agreed not to use export subsidies on agricultural goods exported directly or indirectly to the other country. Each country has also agreed not to sell agricultural goods in the other country at a price below the acquisition price plus handling, storage and other costs. This will prevent the use of practices such as dual pricing. The Agreement will not limit other forms of production subsidies in either country.

Canada has agreed to exclude from the transport rates established under the Western Grain Transportation Act (WGTA) agricultural goods originating in Canada and shipped via West Coast ports for consumption in the U.S. These subsidies were instituted by Canada in 1984 as an expansion of the Crow's Nest Act. It is anticipated that this will primarily affect shipments of millfeed and rapeseed meal into the U.S. Pacific Northwest. The Agreement will not affect WGTA subsidies on shipments through Eastern ports (Thunder Bay), which are not conditioned on export and have been in place since 1897.

These provisions do not prevent imposition of antidumping or countervailing duties.

Access Issues

Grains: Canada has agreed to eliminate import licenses for U.S. wheat, barley, oats and their products when U.S. government support for the particular crop is equal to or less than that of Canada. Each country will calculate its own support level in accordance with a methodology set forth in the Agreement. There is a mechanism to resolve any disagreement over the other country's calculation. When it occurs, the elimination of licenses will provide greater access for the U.S. to the Canadian market for both grains and processed products containing grains.

The Agreement will not affect the ability of either country to legislate changes in domestic support programs for agricultural products. Both countries have also reserved the right to impose or reimpose import restrictions on particular grains if imports increase significantly as a result of a substantial change in either country's support programs for that grain.

Meat: In evidence of the spirit of free trade, the two countries will exempt each other from import quotas applied under their respective meat import laws, unless those imports are frustrating import restrictions on meat imports from other countries. This is a further step ensuring access to each other's markets. This provision will not allow the transshipment or substitution of meat from third countries to circumvent the respective meat import laws. Direct third country access to the U.S. for meat will remain unchanged by the Agreement.

Poultry and Eggs: Canada has agreed to increase the base level for its import quotas for eggs, chicken, turkey and products thereof to a level reflecting total shipments over the last five years. This provision will increase the amount of guaranteed access into Canada. As a result of the tariff reductions, U.S. exporters should have a competitive advantage over other potential supplying countries for the increased quotas.

Sugar: The U.S. has agreed not to impose import restrictions on products from Canada containing ten percent or less sugar for purposes of restricting the sugar content of those products. This provision will not limit the ability of the U.S. to restrict the entry of processed products with higher than ten percent sugar content for purposes of protecting the sugar program.

Technical Regulations

The U.S. and Canada have agreed to work together to harmonize, to the greatest extent possible, technical regulations affecting agricultural, food, beverage and certain related goods. These provisions will facilitate trade for both countries by eliminating, where possible, technical requirements that can amount to non-tariff trade barriers. Specific schedules address the following areas: feeds; fertilizers; seeds; animal health; veterinary drugs; plant health; pesticides; food, beverage and color additives; packaging and labeling; meat, poultry and egg inspection; dairy, fruit and vegetable inspection, and unavoidable contaminants in food and beverages.

Chapter Eight: Wine and Distilled Spirits

Export opportunities for U.S. producers of alcoholic beverages have been limited by measures in Canada that discriminate against the internal sale and distribution of imported products in Canada. The Agreement does not prohibit the regulation of alcoholic beverages in either country, but does eliminate the most significant existing discriminatory practices in Canada and prohibit discrimination against the products of the other country for all new regulations.

Listing measures (limits on brands or types of products that may be sold) must no longer discriminate against wine or distilled spirits of the other country. The lone exception to this requirement is that the province of British Columbia may continue to grant automatic listing to certain estate wineries, provided that listing measures do not otherwise discriminate. Criteria for decisions on listings must be based on normal commercial considerations and listing measures cannot be used to create disguised trade restrictions. Further, listing measures must include procedures for a fair a expeditious appeal when an application for a listing is denied.

The Agreement requires the elimination of discriminatory pricing measures for wine and distilled spirits, including charging a higher markup for U.S. products than locally produced products. Any existing markups must be eliminated when the Agreement is implemented for distilled spirits and must be phased out by January 1, 1995 for wine (with half of the differential to be eliminated by January 1, 1990). Differential pricing measures may only be maintained if the differential between products of the two countries does not exceed the additional cost of service for imported products relative to domestic products. Any such cost of service differential will be subject to audit to ensure it reflects actual higher costs rather than arbitrary protection for local products.

The Agreement prohibits discrimination between Canadian and U.S. wine and distilled spirits in terms of the distribution system for these products. However, on-premise sales by a winery or distillery solely for items produced by them may continue. Private wine store outlets existing on October 4, 1987 in Ontario and British Columbia may continue to discriminate in favor of wine produced in those provinces, but distribution measures in those provinces must otherwise provide nondiscriminatory treatment. Quebec is also allowed to continue to require that wine sold in grocery stores must be bottled in Quebec, as long as alternative outlets for U.S.-bottled wine are provided.

Canada has also agreed to eliminate any measures which require that distilled spirits imported in bulk must be blended with Canadian spirits in order to be sold in Canada.

Canada will recognize Bourbon Whiskey as a distinct product manufactured in the United States and the United States will recognize Canadian Whiskey as a distinctive product of Canada.

Tariffs

Tariffs on whiskey and rum will be eliminated when the Agreement takes effect. Tariffs on other distilled spirits, wine and beer will be phased out in ten equal annual amounts so that duty free status will be obtained on January 1, 1998.

Chapter Nine: Energy

Energy is the single most important input for a developed economy. Without it, there could be no basic industries such as chemicals, steel and other primary metals, autos, aviation, and pulp and paper. All of these industries require energy as a key input and some also manufacture products whose use depends on the availability of energy. Thus, assuring secure supplies of energy at stable and reasonable prices is an essential priority of U.S. economic and trade policy.

The U.S. is the world's largest energy consumer. Although we are also one of the leading producers of energy, the requirements of our economy for various forms of energy are so great that we must import significant amounts of energy to meet these needs. Canada is by far our largest energy supplier. We import more crude oil and petroleum products from Canada than from Saudi Arabia, Venezuela or Mexico. Canada supplies almost all of our natural gas and electricity imports, and more than two-thirds of our uranium imports. In addition, Canada is our largest coal export market. The U.S. and Canada share the world's largest bilateral energy trade relationship, with two-way trade of $10 billion per year or more.

Regrettably, the history of this trade has been marked by a considerable degree of government intervention on both sides, in the form of export restrictions, minimum export price requirements, import fees and quotas, and various other trade restrictions. There have also been domestic programs in each country which have distorted trade both in energy itself and in energy-intensive products such as petrochemicals. While these past actions have often been in response to short-term concerns, they have generally worked to the longer-term disadvantage of both countries. At times, artificially low prices have stimulated excess demand while suppressing supply and thus causing shortages. At other times, artificially high prices have stifled economic activity throughout the economy, especially in energy-intensive industries. Overall, the uncertainty about future government energy trade policies and actions has inhibited investment in energy production and energy consuming industries in both countries.

The Agreement builds on the lessons learned from the past by renouncing excessive government interference in our future energy trade and provides a framework for rational economic development of that trade. Because it will encourage the most efficient system for production, distribution and use of energy between the two countries, it will enhance the energy security of both countries. It should also result in lower overall energy costs over the longer term, which will contribute significantly to the international competitiveness of basic industries in each country.

The energy goods covered by the Agreement include petroleum, natural gas, coal, electricity, uranium and other nuclear fuels.

The Agreement reaffirms the rights and obligations of both the United States and Canada with respect to the GATT prohibitions on import and export restrictions. Moreover, it makes explicit that both countries interpret the GATT to prohibit minimum export price requirements. In addition, the Agreement extends the GATT discipline to cover a prohibition on export taxes.

In an annex, the Agreement lists three specific changes to conform existing laws to these commitments: (1) The U.S. will exempt Canada from any potential restrictions on enrichment of foreign uranium which might be imposed under Section 161v of the Atomic Energy Act; (2) Canada will exempt the U.S. from its export restrictions on unprocessed uranium; and (3) the U.S. will allow Canada access to a maximum of 50 thousand barrels per day of Alaskan oil currently restricted from export under Section 7(d) of the Export Administration Act, subject to the condition that this oil will be transported to Canada from a suitable location in the Lower 48 States.

The Agreement affirms that, as provided by the GATT, either country may restrict exports where necessary to respond to supply shortages, to maintain a domestic price stabilization program or to prevent exhaustion of a finite energy resource. However, it may impose a restriction only if the restriction (1) does not reduce the proportion of total supply historically available to the other country; (2) does not disrupt the normal channels of supply or mix of energy products; and (3) does not impose a higher price on exports than for comparable domestic sales. What this means is that neither country will treat the buyers or sellers of energy of the other country as "second-class" customers or suppliers. Canada gains assured market access for its energy exports to the U.S., and the U.S. gains assured access to Canadian supplies for its imported energy requirements.

The Agreement provides for consultation in the event either country believes the energy regulatory actions of the other country would directly discriminate against its energy goods or businesses.

An annex to the Agreement lists regulatory changes to be made to conform to the Agreement. Canada will eliminate its electricity export price test that requires the export price to be not significantly less than the least-cost alternative available to the importer. Other Canadian export tests (price tests and "surplus" tests) must be administered in a manner consistent with the principles of the Agreement.

The U.S. will eliminate any discriminatory treatment of British Columbia Hydro vis-a-vis comparably situated U.S. utilities in terms of access to the Bonneville Power Administration Intertie into the California electricity market. In addition, it is expected that long-term arrangements will be negotiated to assure the development of electricity trade in a mutually beneficial manner consistent with the objectives and principles of the Agreement.

The Agreement recognizes the importance of government incentives for oil and gas resource development to the energy supply security of both countries and, therefore, allows such incentives to be maintained or created. This provision does not prevent the imposition of antidumping or countervailing duties.

The Agreement provides for only quite narrow exceptions to the prohibition on trade restrictions in situations involving national security; these are limited to situations of militarily related national security. The Agreement declares that there is no inconsistency between this Agreement and the obligations of either country under the International Energy Program of the International Energy Agency.

Chapter Ten: Trade in Automotive Goods

Automotive trade accounted for over one-third, or $46 billion, of the total bilateral trade between the U.S. and Canada in 1986. Under the U.S.-Canada Automotive Products Trade Agreement (Auto Pact) of 1965, 95 percent of bilateral automotive trade already moves duty-free. As a result of the FTA, all automotive trade will be duty-free, as long as it meets the rule of origin.

The U.S. and Canada have agreed to the removal of tariff and nontariff barriers and new origin rules designed to assure that the benefits of the FTA accrue to North American auto and auto parts producers. By removing trade and investment distorting practices, the FTA will encourage greater efficiency in motor vehicle production and will provide greater assurance that economic factors determine trade and investment choices between the U.S. and Canada.

Tariffs and Rule of Origin

All tariffs on U.S. and Canadian motor vehicles and parts will be eliminated by January 1, 1998. Most will be phased out over 10 years, but tariffs on aftermarket parts will be eliminated in five years.

The FTA rule of origin which is described in the chapter on rules of origin will apply to all U.S. imports of Canadian automotive products, but only to Canadian imports of U.S. automotive products not entering Canada under the Auto Pact. The FTA rule is based on change in Harmonized System tariff classification and includes a 50 percent U.S.-Canadian direct cost of manufacturing test for vehicles and specified assembled parts.

Here is how the new FTA rules and the existing Auto Pact will work for imports of autos and parts into the U.S. from Canada:

> The FTA rule of origin will replace the rule currently used by the U.S. to implement the Auto Pact. Upon implementation of the FTA, those motor vehicles and original equipment parts currently eligible for duty-free entry under the Auto Pact will be able to enter the U.S. duty-free only if they meet the new FTA rule of origin. Other auto parts that meet the FTA rule of origin will pay the FTA tariff until it is fully eliminated. Motor vehicles and parts that do not meet the FTA rule of origin will pay the full current most-favored-nation (MFN) duty, not the FTA duty.
>
> The new rule of origin is tougher in that it requires that substantial manufacturing costs (materials and direct processing costs) be incurred in the U.S. and/or Canada, while the current test only assures that substantial costs (which can include advertising and overhead) or profits are incurred in the U.S. and/or Canada. This change will help both U.S. and Canadian auto parts manufacturers.

Here is how the new FTA rules and the existing Auto Pact will work for imports of autos and parts into Canada from the U.S.:

> Canada's criteria for duty-free access into Canada under the Auto Pact will not change. Qualified producers (those that meet Canada's performance requirements) will continue to be able to import motor vehicles and parts into Canada duty-free from anywhere in the world. However, it has been agreed in the FTA that no new firms may qualify for Auto Pact or Pact-like benefits in Canada, except for the General Motors-Suzuki (CAMI) joint venture, if it qualifies by the 1989 model year.
>
> For companies not meeting Canada's Auto Pact performance requirements, the FTA tariff will apply (until it is fully eliminated) to products imported from the U.S. that meet the FTA rule of origin. Motor vehicles and parts that do not meet the FTA rule of origin will pay the full current most-favored-nation (MFN) duty, not the FTA duty.

Duty Remission

Canada's export-based duty remission program will be eliminated January 1, 1989 on exports to the U.S. and terminated in all cases by January 1, 1998. The export-based duty remission program allows firms in Canada to reduce duties on motor vehicle and part imports in proportion to the Canadian value-added in their exports of automotive parts.

Canada's production-based duty remissions will end by January 1, 1996 or earlier as contracts expire. Production-based duty remissions allow firms that are not members of the Auto Pact in Canada to avoid duties on automotive imports into Canada as long as they meet Canadian local content requirements.

There will be no new recipients of any Canadian automotive duty remission benefits, and current benefits will not be enhanced. U.S. and Canadian auto parts manufacturers will benefit from the elimination of these measures, which distort trade and investment.

Other Provisions

Canada will phase out its embargo on the importation of used vehicles over five years.

A Select Panel will be established to assess the state of the North American industry and to propose public policy measures and private initiatives to improve its competitiveness in domestic and foreign markets.

Chapter Eleven: Emergency Action

One of the basic tenets of the GATT trading system is that countries should be allowed to take temporary emergency actions restricting imports in order to remedy serious injury caused by increased imports. The drafters of the GATT recognized that a country would be more willing to enter into contractual obligations to reduce its trade barriers if it were able to reimpose the duties when and if imports of a particular product increased to such an extent as to cause injury to one of its industries producing a competing product. Both the U.S. and Canada have established "safeguard" procedures to provide emergency relief to domestic industries injured by imports.

The Agreement provides a two-track system aimed at preserving the existing rights of workers and firms in both countries to gain relief from import-related injury, while at the same time assuring the U.S. and Canadian business communities that the trade expansion created by the FTA will not be suddenly and arbitrarily cut back. Although the U.S. and Canada have not used such actions against each other very often, the possibility of taking actions reduces certainty of market access.

In the United States, domestic producers and workers will have access to relief under special revised provisions of Section 201 of the Trade Act of 1974.

Under the bilateral track, if imports resulting from FTA duty reductions cause serious injury, the importing country may reinstate the pre-Agreement tariff or current MFN duty (whichever is lower), or suspend duty reductions. This can be done only once per product during the ten-year transition period for no longer than three years. After the transition period, such actions can only be taken by mutual agreement.

Under the global track, the FTA partners retain their GATT rights except that the importing country must exclude the other from an action involving other countries unless that country's imports are substantial and are found to be contributing importantly to the injury from imports. For purposes of this track, imports in the range of five percent to ten percent or less of total imports would normally not be considered substantial. "Contributing importantly" means an important cause, but not necessarily the most important cause.

If the exporting country is initially excluded from an import relief action, the importing country has the right to subsequently bring that country's trade under the import restraint action in the event of a surge in imports from that country. In no event may the exporting country's exports be cut back below the level they reached during a reasonable recent base period.

The FTA partner taking either a bilateral or global action must provide compensation aimed at expanding trade in another product or the exporting FTA partner may take a substantially equivalent retaliatory action.

Disputes arising after an action is taken are subject to binding arbitration under the dispute settlement provisions of the FTA.

Chapter Twelve: Exceptions for Trade in Goods

The Agreement incorporates the provisions of the GATT allowing for exceptions from GATT rules for limited reasons, such as to protect public health or morals or national treasures.

It also specifies certain miscellaneous exceptions from the FTA, including both countries' export controls on logs and existing East Coast Canadian export restrictions on unprocessed fish. Both countries' practices on the internal sale and distribution of beer are also exempted, but amendments to existing practices cannot deviate more from the obligations of the Agreement, and new measures must conform with the FTA.

GATT rights with respect to measures exempted from the FTA are expressly preserved.

PART THREE: GOVERNMENT PROCUREMENT

The general provisions regarding goods trade in Part Two do not apply to purchases of goods by governments.

Chapter Thirteen: Government Procurement

The Agreement expands the size of the government procurement markets which will be open to free and fair competition between U.S. and Canadian suppliers. It also establishes a solid framework for further elimination of "buy national" restrictions that presently inhibit sales by U.S. exporters to Canada.

The procedures used in the Agreement for government purchases build upon the open and competitive principles and procedures of the GATT Government Procurement Code. It improves Procurement Code procedures by establishing a common rule of origin, requiring an effective bid challenge system for all potential suppliers and improving transparency of bid selection, particularly for procurements which are single tendered. The U.S. currently provides for effective bid challenge procedures but Canada does not.

The U.S. and Canadian governments apply various buy national preferences in favor of suppliers of domestic goods. These preferences inhibit -- and in some cases prevent -- competition from foreign products. Under the Agreement, suppliers of goods which are manufactured in the U.S. and Canada and which contain at least 50 percent U.S. or Canadian content will be treated on an equal basis to suppliers of domestic goods for covered procurements.

"Buy American" and "Buy Canadian" restrictions are eliminated on the procurement of goods by U.S. and Canadian entities covered by the GATT Government Procurement Code between the Code threshold (for 1987, $171,000) and an FTA threshold of $25,000, and are subject to the same exclusions and exceptions as those covered by the Code.

Viewed in conjunction with the Procurement Code, the FTA will allow U.S. exporters to compete on a nondiscriminatory basis for all Code-covered procurements over $25,000.

The value of procurement opportunities covered by this chapter is estimated at approximately $3 billion of U.S. procurement and $500 million of Canadian procurement. Previously a majority of Canadian purchases were below the Code threshold, versus a small minority for U.S. entities. Therefore, Canadian entities will open a much higher percentage of procurements under the FTA than will U.S. entities. As a result of the new opportunities offered by Canadian entities under this chapter, procurement opportunities in Canada for U.S. exporters are increased by more than 100 percent.

Principles are established for bid challenge procedures. These include a requirement that a reviewing authority with no substantial interest in the outcome of the procurement be responsible for deciding bid challenges. Suppliers may protest government procedures on their own initiative and receive timely settlement of complaints.

Each government must provide transparency in its procurement process. Public notice must be provided of all the criteria it intends to use in evaluating a bid (including offsets) and the award must be based on those criteria.

Within one year after the conclusion of the current multilateral negotiations on the GATT Procurement Code, there will be an opportunity to improve and expand coverage of this chapter by further negotiations with Canada.

PART FOUR: SERVICES, INVESTMENT AND TEMPORARY ENTRY

GATT rules cover trade in goods only. Services and investment are not covered. The FTA goes beyond traditional GATT areas to establish rules in these areas that break new ground and set an important precedent for the Uruguay Round of multilateral trade negotiations, in which GATT countries are considering whether to extend GATT disciplines to these new areas.

Chapter Fourteen: Services

The Agreement breaks new ground by providing rules governing trade and investment in services industries. Both the U.S. and Canada have relatively open markets for services. The Agreement will ensure continued openness by providing that future laws and regulations will not discriminate against services providers of the other country.

A wide range of services industry sectors are covered by the agreement, including: construction, tourism, insurance, telecommunications-network-based enhanced services and computer services, some professional services, services relating to mining and agriculture, wholesale and retail trade, management services and other business services. Transportation services are not covered.

Future U.S. and Canadian government measures such as laws, regulations or licensing requirements affecting services trade and investment must not have the purpose or effect of discriminating between the services providers of either country. The right of establishment, the right to sell across the border, and greater transparency in regulations are also provided. The Agreement does not affect subsidies for or government procurement of services.

There are annexes which clarify the application of the services agreement to architecture, tourism, and telecommunications-network-based enhanced services and computer services.

In architecture, both sides will review the work of professional organizations to develop mutually acceptable standards.

In telecommunications-network-based enhanced services and computer services, the Agreement ensures the future development of an open and competitive market including access to and use of the basic telecommunications network.

In tourism, the Agreement ensures continued open markets for tourists and tourism service providers.

The Agreement provides the opportunity for future negotiations to increase liberalization, sectoral coverage and other obligations.

Chapter Fifteen: Temporary Entry for Business Persons

The U.S. and Canada have agreed that as a part of the special trading relationship established by the Agreement, it is desirable to facilitate temporary entry for business persons into the territory of each country on a reciprocal basis. The Agreement and immigration laws of both countries will provide transparent criteria and procedures for temporary entry of certain persons who conduct trade in goods and services as well as investment activities, while maintaining necessary provisions to ensure border security and protect indigenous labor and permanent employment. These provisions facilitate entry for citizens of each country into the territory of the other on both a short- and long-term basis depending on the type of commercial activity involved.

The two countries agree to provide temporary entry for business persons through transparent laws and regulations and to provide explanatory materials in order to enable business persons to become acquainted with such laws and regulations. These provisions will be applied in a manner that provides the desired entry without undue delay or impairment in the conduct of trade and investment under the Agreement.

The countries will exchange data on temporary entry and consult at least once a year concerning the operation of the Agreement and consider provisions that may further enhance temporary entry, including amendments and additions to coverage of persons under the Agreement.

Should a dispute arise concerning the provisions of this chapter, it may be referred to the dispute resolution provisions of the Agreement if the matter involves a pattern of practice and available administrative remedies have been exhausted.

Coverage of persons involves Business Visitors and Professionals who shall be admitted without prior approval procedures, petitions, labor certification tests, or other procedures having similar effect, as well as Intra-Company Transferees and Traders and Investors who will no longer face labor certification tests or other similar procedures.

Business Visitors

A business person engaged in one of the covered occupations and entering for the described purpose shall be granted entry under Schedule 1 of the Agreement. This schedule defines the persons involved in a number of business areas and the activities undertaken. The approach provides transparency and specificity to a number of areas of business activity that have in the past been unclear or subject to conflicting interpretation.

One important provision allows persons of either country to provide after-sales service for the length of the contract or warranty period on commercial or industrial machinery and equipment or computer software that has been purchased outside its territory. This allows firms to better provide after-sales service functions that are often a necessary component in the sale of complex machinery, equipment and computer software.

Traders and Investors

A business person seeking temporary entry in order to carry on substantial trade in goods or services in a capacity that involves supervisory, executive or essential skills, or to direct the operations of an enterprise in which the person has invested, shall be granted temporary entry under new, liberalized procedures in the Agreement. The new provisions provide business persons the assurance that after they have received an initial certification, they may freely enter as often as their business needs require.

Professionals

The FTA partners will admit persons who are members of certain professions and engaged in their related business activities. Coverage includes the generally recognized professions such as engineers, architects, and certain scientific and technical specialties. The Agreement also covers newer professions such as management consultants. Revised procedures should provide improved processing of entry requests.

Intra-Company Transferees

Intra-company transferees, when engaged in managerial or executive activities or possessing specialized knowledge, will be admitted. Requirements that certain companies train replacement personnel have been removed.

Chapter Sixteen: Investment

For U.S. investment in Canada, the Agreement builds on the substantial liberalization measures already taken by the present Canadian government. It freezes those measures in place and bars most new measures which would adversely affect U.S. investment.

For its part, the U.S. will continue its open investment climate for Canadian investors in accord with the basic principles set out in the President's Investment Policy Statement of September 9, 1983.

The Basic Rules

The Agreement sets out four basic rules to govern the treatment of investors from each country:

National Treatment and Non-discrimination: Each party is to treat investors of the other party at least as favorably as its own investors (in like circumstances) with respect to the establishment of new businesses and the acquisition of existing business, and with respect to the conduct, operation and sale of business enterprises located in its territory. Neither party, thus, can require that investors sell investments by reason of their nationality, or that their own nationals must hold a minimum level of equity in investments made by investors of the other country.

Elimination of Performance Requirements: Neither party, when permitting an investment in its territory, or when regulating an investment, may impose or enforce trade-distorting measures which require an investor to export a certain amount of goods, or substitute locally produced goods for imports, or buy or give a preference to locally produced goods. (This rule also applies to third country investors when such measures could significantly affect U.S.-Canadian trade.)

Expropriation Only in Accordance with International Law Standards: Neither party may directly or indirectly expropriate the holding of an investor from the other country except in accordance with generally accepted international law standards which, inter alia, require payment of prompt, adequate and effective compensation at the fair market value of the expropriated properties.

Free Transfer: Neither party may prevent an investor from transferring profits, earnings from an investment, or sales and liquidation proceeds (with only limited exceptions relating, for example, to limitations on dividend payments set by bankruptcy laws.)

Exceptions

Certain measures are excluded, notably those involving transportation services. The provision of financial services (except certain insurance measures) are covered elsewhere in the Agreement.

In general, existing measures are grandfathered, such as the existing U.S. laws restricting foreign investment in such fields as atomic energy and communications and the Canadian laws restricting foreign investment in communications. Those measures may not be made more restrictive.

The oil and gas and uranium mining industries were subject to published policies under the Investment Canada Act prior to October 3, 1987; the application of these policies and of the thresholds of the Agreement to these industries is to be clarified by an exchange of letters.

Liberalization of Entry and Exit Restrictions

The Agreement does achieve major liberalization of Canada's Investment Canada Act, which is Canada's principal mechanism for regulating investment into Canada and, a fortiori, sales of Canadian businesses to foreign investors.

Canada's threshold for review of direct acquisitions by U.S. investors is raised to C$150 million (in constant 1992 Canadian dollars) after three years from the date of entry into force of the FTA.

Canada will no longer review indirect acquisitions after the end of that three-year period.

Canada also will apply these higher thresholds to an acquisition by a foreign investor when a U.S. investor seeks to sell its Canadian business.

Canada will offer to buy, at a fair open market price (determined by independent assessment) any business enterprise in Canada in the cultural industry which Canada requires be divested when reviewing an indirect acquisition. If, for example, a U.S. firm seeks to buy another U.S. firm with a Canadian subsidiary in a cultural industry, Canada may require the new owner to divest the cultural subsidiary to a Canadian purchaser. (The FTA exempts cultural industries generally from the Agreement, and therefore from the Chapter.)

Canada will no longer impose certain trade-distorting performance requirements under the Investment Canada Act. These are requirements to export, substitute local production for imports, source or purchase locally, or achieve specified domestic content.

PART FIVE: FINANCIAL SERVICES

Chapter Seventeen: Financial Services

This is the first U.S. bilateral agreement covering the entire financial sector. It removes essentially all existing discrimination faced by U.S. financial institutions operating in Canada, allows the flexibility to acquire Canadian financial services firms, improves access between our markets, and allows financial firms on both sides of the border to compete on a more equal basis. Canadian financial institutions will continue to enjoy the current treatment and open access they now receive in the U.S. financial market.

The Agreement covers all current and future laws, regulations, and practices relating to financial institutions in both countries. Financial institutions include commercial banks, investment banks, trust and loan companies, savings-and-loan institutions, certain activities of insurance companies, and other institutions so designated under the laws of each country. (Financial services offered by nonfinancial institutions and insurance services are covered elsewhere in the Agreement.)

The domestic assets of foreign bank subsidiaries operating in Canada (the "closely held" or Schedule B banks) are currently limited to 16 percent of all domestic assets of the Canadian banking system. Foreign bank subsidiaries also face individual capital limits and other restraints such as the sale of loans to the parent bank. Under this agreement, U.S. commercial bank subsidiaries will be exempt from the current restrictions on market share, asset growth, and capital expansion, in the same way that Canadian banks are free from these restraints. U.S. commercial banks will also be allowed to establish or acquire securities firms or federally-regulated Canadian insurance and trust companies, again in the same manner as Canadian banks.

Under the current proposals for financial market reform in Canada, foreign insurance companies have perhaps been the most disadvantaged because of the so-called "10/25" rule. This prevents a nonresident from acquiring more than 10 percent ownership of a Canadian insurance company, or trust and loan company; total nonresident ownership is limited to 25 percent. Under the

Agreement, U.S. insurance firms will now receive the same rights as Canadian insurance companies to diversify in the financial sector by establishing or acquiring federally-regulated insurance companies, trust companies, Schedule B banks, or securities firms.

While Ontario, Quebec, and other provinces have liberalized their securities markets and opened them to foreign investors, the federal government implemented a policy of reciprocity which has held up the applications for entry by U.S. securities firms and banks. Under the Agreement, these applications will be reviewed on a prudential basis, just as for Canadian firms, rather than on a reciprocity basis. U.S. securities firms established in Canada will have the ability to diversify through a holding company structure into other financial activities such as banking and insurance.

Under the Agreement, the U.S. also made a number of specific commitments, although there were no national treatment barriers in the United States to eliminate. The U.S. agreed to guarantee the right of Canadian banks to retain their multi-state branches that were grandfathered under the International Banking Act of 1978. If the Glass-Steagall Act, which separates commercial and investment banking in the U.S., is amended, the U.S. will extend these benefits to Canadian financial institutions in the U.S. Such guarantees have never before been extended to any other country.

The U.S. responded to Canadian concerns regarding the treatment of their banks and securities firms which merge in Canada, but have operations in the U.S., by agreeing to allow Canadian banks (as well as U.S. and other foreign banks) in the U.S. to underwrite and deal in debt obligations fully backed by Canada or its political subdivisions. This is a new power that is consistent with the existing ability of banks to underwrite and deal in securities of the U.S. Government and its political subdivisions, yet does not undermine the basic tenets of the Glass-Steagall Act.

The new power enables Canadian firms to take advantage of liberalization in Canada, while retaining the most important securities activities in the U.S. One of the side effects of this new power will be a direct benefit to the Canadian federal government, the Agent Crown corporations, the provincial governments, and the municipal governments in Canada. Since, as a result of the agreement, their debt will be underwritten and traded by more firms in the U.S., it offers the potential for a wider, deeper market and, therefore, lower borrowing costs.

In addition to these specific commitments, both the U.S. and Canada have made general commitments. The U.S. has agreed to continue the current treatment provided to Canadian financial institutions established in the U.S. as long as Canada continues to liberalize its financial markets and to extend the benefits to U.S. financial institutions established in Canada. Canada has made an analogous commitment. The Agreement establishes a formal consultative mechanism between the U.S. Department of the Treasury and the Canadian Department of Finance to oversee this liberalization and deal with any other financial services issues.

PART SIX: INSTITUTIONAL PROVISIONS

This part establishes procedures for general dispute settlement and the special arrangements for antidumping and countervailing duties.

Chapter Eighteen: Institutional Provisions

The Agreement provides for a consultative mechanism to avoid disputes and resolve any disagreements quickly and easily, with provisions for use of binational panels of independent experts for unresolved disputes.

The Canada-United States Trade Commission is established to supervise the implementation of the Agreement and to resolve disputes on all matters except financial services, antidumping and countervailing duties. The Commission will be composed of Cabinet-level representatives of both governments and will operate by consensus.

Either government may request consultations and will attempt to avoid or resolve disputes through consultations. If consultations are unsuccessful, either government may request a meeting of the Commission. The Commission may use a mediator or draw on expert advice in seeking a bilateral settlement. If not resolved in this manner, the Commission may agree to refer the matter to binding arbitration or a panel can be established at the request of either party.

A panel will be appointed from a roster maintained by the Commission. Two panelists will be appointed by each government and a fifth, the chairman, will be jointly agreed, selected by the other four, or chosen by lot. The panel, after hearing the arguments of both sides, will report its findings and recommendations to the Commission. If either side believes the panel has erred, it may present written objections to the panel, which may reconsider and revise its final report.

After receiving the panel's final report, the Commission will agree on the resolution of the dispute, whenever possible removing the nonconforming measure rather than paying compensation. If the Commission cannot agree and a government believes its fundamental rights or benefits under the FTA are being impaired, that government may withdraw equivalent benefits from the other.

Chapter Nineteen: Binational Dispute Settlement in Antidumping and Countervailing Duty Cases:

The U.S.and Canada will continue to apply their own national antidumping (AD) and countervailing duty (CVD) laws to goods imported from the other country. In such cases, independent binational panels acting in place of national courts will expeditiously review final AD and CVD determinations to decide whether they are consistent with the AD or CVD law of the country that made the determination.

The panel procedure -- combining independent review and judicial standards with an FTA-created forum and a tight schedule -- will allow quick resolution of AD/CVD issues between the two countries without unnecessary bilateral trade friction, yet preserve the rights of injured companies to obtain relief from unfair trade practices. The panel mechanism will remain in place for up to seven years, while a bilateral working group attempts to develop new approaches to unfair pricing and government subsidies that would ensure effective discipline over unfair trade practices and minimize unfair trade disputes within the new free trade area.

Under the FTA's panel procedure, independent binational panels will review final AD and CVD determinations by the relevant administrative agencies of the U.S. and Canada. In one FTA country's AD or CVD case involving a product from the other FTA country, panels would substitute for national courts unless, in a particular case, no party preferred panel to court review. Panel decisions would be binding as a matter of international law with respect to the particular matter reviewed. This system of review would apply to final determinations made by an administrative agency after the date of entry into force of the Agreement. It will not affect either country's judicial review of AD/CVD cases concerning imports from third countries.

In the U.S., the Department of Commerce makes final dumping or subsidy determinations in AD/CVD investigations and reviews of AD/CVD orders, and the U.S. International Trade Commission makes final determinations in AD/CVD investigations as to whether a U.S. industry has been injured. These determinations in a U.S. case involving goods from Canada, and Canada's parallel determinations in a Canadian case involving goods from the U.S., will be subject to panel review. This symmetry in the panel review process will enhance the rights of U.S. producers and exporters, since judicial review of some Canadian dumping and subsidy findings is not now available.

The panels will review final AD/CVD determinations solely to determine, based on the administrative record, whether the relevant administrative agency applied its national AD/CVD law correctly. The panels will employ the same standard of review and the same general legal principles as would a domestic court. If a panel finds that the administrative agency applied the law correctly, it will affirm the determination. Otherwise, it will send the case back for a corrected determination.

Although formally only the two governments may invoke the panel review process, the governments will automatically trigger panel review at the request of any person who otherwise could have challenged the determination in court. Parties to the case or their lawyers will argue their positions before the panel, as they would before a court. Sensitive business information will be protected against unlawful disclosure in the panel review process.

Panelists will generally be selected from a roster to be developed by the two governments. Individuals on the roster will be U.S. or Canadian citizens chosen for objectivity, reliability, sound judgment, and general familiarity with international trade law. To ensure impartiality, roster members, with the exception of judges, may not be government officials. Individual panels will have five members, the U.S. and Canada each appointing two. The fifth panelist will be chosen by agreement between the two governments, among the four panelists, or by lot from the roster. Because panels will be performing a judicial-like function, a majority of the panelists including the chairman must be attorneys.

The two governments expect the panel system to work smoothly and effectively. As a safeguard against an impropriety or gross panel error that could threaten the integrity of the process, however, the FTA provides for an "extraordinary challenge procedure." In carefully defined circumstances, either government could appeal a panel's decision to a three-member committee of U.S. and Canadian judges or former judges. The committee would make a prompt decision to affirm, vacate, or remand the panel's decision.

The Agreement also establishes a procedure for advisory panel review of amendments to U.S. or Canadian AD or CVD laws enacted after the FTA enters into force. The two governments will consult about any proposed AD/CVD amendments applicable to the other country's goods. If one country changes its AD or CVD statutes, the other government may request that a panel be established to give an advisory opinion on whether the amendment is consistent with the GATT and the FTA.

If the panel views the amendment as inconsistent with the GATT or the Agreement and recommends modifications to eliminate the inconsistency, the two governments will consult to reach a solution, which could include seeking remedial legislation. If no agreement is reached or remedial legislation agreed on is not enacted, the complaining government may enact a comparable amendment to its AD/CVD law or terminate the Agreement upon 60 days' written notice.

PART SEVEN: OTHER PROVISIONS

Chapter Twenty: Other Provisions

Provisions which did not fall logically into other chapters appear here. Included are some particular sectoral issues, as well as some general rules affecting the overall Agreement.

Softwood Lumber

The 1986 Memorandum of Understanding (MOU) on Softwood Lumber is grandfathered. The MOU resolved a countervailing duty case brought by the U.S. softwood lumber industry against Canada's lumber exports. Canada agreed to apply a 15 percent export tax on lumber until such time as the provincial stumpage pricing practices were altered.

Plywood

Canada will decide by March 15, 1988 whether to allow the use of U.S. standard C-D grade plywood in housing it finances. If so, U.S. tariff concessions on plywood and particleboard will begin to be implemented on January 1, 1989. If not, a panel of experts will examine the issue and the governments will consult on how to implement the tariff concessions.

Culture

It has been the policy of Canadian governments to promote cultural activities with the goal of fostering Canada's unique cultural heritage. Some of these measures have had trade effects and an adverse impact on U.S. commercial interests.

The U.S. recognizes the importance to Canada of maintaining its cultural identity. At the same time, however, the U.S. wants to ensure that Canadian cultural policies do not constitute a discriminatory and unnecessary barrier to U.S. trade.

Certain "cultural industries" are exempt from the provisions of the FTA. This allows either country to maintain programs that would otherwise be inconsistent with the Agreement. However, the other country retains the right to retaliate with measures of equivalent commercial effect whenever the cultural exemption hurts that country's commercial interests. The right to take countermeasures is not subject to prior invocation of the Agreement's dispute settlement provisions.

Cultural activities exempted from the FTA include the publication, sale, distribution or exhibition of: books, magazines, and newspapers; film and video recordings; audio or video music recordings; and also radio, television and cable dissemination. Of course, tariffs will be eliminated on all these products.

In addition, Canada has agreed to alter a number of practices that discriminate against U.S. businesses. These new steps include elimination of a print-in-Canada requirement for tax benefits and increased copyright protection for the retransmission of commercial broadcasts.

Other Provisions

The two governments agreed that if either takes trade actions to counteract a serious deterioration in its balance-of-payments position, it will do so consistent with its rights and obligations under the GATT, the International Monetary Fund and the Organization for Economic Cooperation and Development.

The precedence of the 1980 tax convention is stated because the Agreement takes precedence over other agreements unless specified.

The standard GATT national security disclaimer is adopted, except for energy and government procurement. For energy, there is a more limited national security provision specified in the energy chapter. For government procurement, the GATT Government Procurement Code provision is adopted.

The establishment of government monopolies is expressly permitted, but it must be done in a way that does not violate the principles of the Agreement.

The Agreement states that if measures not expressly prohibited are deemed nevertheless to nullify or impair benefits reasonably expected under the Agreement, dispute settlement can be invoked.

PART EIGHT: FINAL PROVISIONS

Chapter Twenty-One: Final Provisions

The two governments agree to exchange necessary statistical information and to publish information to facilitate implementation of the Agreement. The Agreement will become effective January 1, 1989. It can be amended by mutual agreement and can be terminated by either party with six months' notice.

For Further Information, Contact:	Area Code 202
The Office of the U.S. Trade Representative	
Office of Canada	395-5663
Office of Public Affairs	395-3230
Department of Commerce	
Office of Canada	377-3101
Office of Public Affairs	377-3808
Department of Agriculture	
Office of International Trade Policy	382-1338
Office of the Press Secretary	447-4623
Department of the Treasury	
Office of International Trade	566-8107
Office of International Investment	566-5811
Canada Desk (Financial Services)	566-2747
Department of State	
Bureau of Economic and Business Affairs	
Office of Trade	647-1718
Office of Public Affairs	647-1942
Bureau of European and Canadian Affairs	
Office of Canadian Affairs	647-1097
Department of Labor	
Office of International Economic Affairs	523-6096
Office of Public Affairs	523-9711
Department of Energy	
Office of Int'l Affairs and Energy Emergencies	586-5800

ACTE/CAN MEMBERS
as of February 1, 1988

ABC Custom Cedar Homes, Inc.	Sonoma, CA
ADC Telecommunications	Bloomington, MN
AT&T	New York, NY
A-C Brake Co., Inc.	Louisville, KY
A.T. Cross Company	Lincoln, RI
ALCOA	Pittsburgh, PA
AMCA International Corporation	Hanover, NH
Aaonton Group, Inc.	Plano, TX
Action Associates	Bloomington, MN
Aerospace Industries Association of America, Inc.	Washington, DC
Air Conditioning and Refrigeration Institute	Arlington, VA
Air Conditioning Contractors of America	Washington, DC
Alaska Quality Control & Technical Services, Ltd.	Anchorage, AK
Albert Seisler Machine Corp.	Mohnton, PA
Alderfer & Herm	Denver, CO
Allied-Signal International, Inc.	Morristown, NJ
Allis - Chalmers Corporation	West Allis, WI
Almerica Overseas, Inc.	Destin, FL
Alpha Research, Inc.	Glendale, WI
Alumax, Inc.	San Mateo, CA
Amatos, Inc.	Middletown, CT
Ambler Organizational Consultants, Inc.	Cherry Hill, NJ
Amerace Corporation	Hackettstown, NJ
Amerex Corporation	Trussville, AL
American Association of Exporters & Importers	New York, NY
American Association of Meat Processors	Elizabethtown, PA
American Business Conference	Washington, DC
American Cast Metals Association	Des Plaines, IL
American Council of Independent Laboratories	Washington, DC
American Electronics Association	Washington, DC
American Express Company	New York, NY
American Federation of Small Business	Chicago, IL
American Frozen Food Institute	McLean, VA
American Furniture Manufacturers Association	Washington, DC
American Gas Association	Arlington, VA
American Institute of Marine Underwriters	New York, NY
American Institute of Small Business	Minneapolis, MN
American Newspaper Publishers Association	Washington, DC
American Retail Federation	Washington, DC
American Street Corridor Business Association	Philadelphia, PA
American Trucking Association	Alexandria, VA
Amigo Sales, Inc.	Bridgeport, MI
Amoco Corporation	Chicago, IL
Archer Daniels Midland	Decatur, IL
Armtek Corporation	New Haven, CT
Arthur Andersen & Company	Chicago, IL
Arthur Young	Dallas, TX

Artmor Plastics Corporation	Cumberland, MD
Associated Builders & Contractors	Washington, DC
Associated Lumber Industries, Inc.	Carbondale, IL
Association of Collegiate Entrepreneurs	Wichita, KS
Atlantic Council Canada Group	Washington, DC
Augat, Inc.	Mansfield, MA
Austad's	Sioux Falls, SD
Avon Products, Inc.	New York, NY
B.F. Goodrich Company	Akron, OH
BP America, Inc.	Cleveland, OH
Babcock & Wilcox, Company	New Orleans, LA
Baker Service Tools	Houston, TX
Baldor Electric Company	Fort Smith, AR
Ball Corporation	Muncie, IN
Ball Publishing Company	Arcanum, OH
Bank of America	San Francisco, CA
Barnes Group, Inc.	Bristol, CT
Barrett Trailers, Inc.	Oklahoma City, OK
Barrios Technology, Inc.	Houston, TX
Barrister Information Systems Corporation	Buffalo, NY
Bearings, Inc.	Cleveland, OH
Beckman Instruments, Inc.	Fullerton, CA
Bemis Manufacturing Company	Sheboygan Falls, WI
Bend Photo Center, Inc.	Bend, OR
Bernard R. Horn Company	Folcroft, PA
Better Business Bureau of Maricopa County	Mesa, AZ
Blair Cartage, Inc.	Newbury, OH
Blatt's Bakery	Put-in-Bay, OH
Boeing Company	Seattle, WA
Bowes Manufacturing, Inc.	Solon, OH
Bristol-Myers Company	New York, NY
Brodart Company	Williamsport, PA
Brooklyn Union Gas Company	Brooklyn, NY
Brown Capital Management, Inc.	Baltimore, MD
Brown Deer Bank	Brown Deer, WI
Brown-Forman Corporation	Louisville, KY
Buffalo Forge Co.	Buffalo, NY
CPC International, Inc.	Englewood Cliffs, NJ
Carbis Walker & Associates	Butler, PA
Cargill, Incorporated	Minneapolis, MN
Carolina Freight Carriers Corporation	Cherryville, NC
Cass County Abstract Company	Fargo, ND
Castite Systems, Inc.	Cleveland, OH
Caterpillar, Inc.	Peoria, IL
Champion International Corporation	Stamford, CT
Charles Beck Machine Corporation	King of Prussia, PA
Charles F. McAfee Architects Engineer Planners	Wichita, KS
Charter Medical Corporation	Macon, GA
Chattahoochee Business Group	Marietta, GA
Chicago Barter Corporation	Lombard, IL
Chicone Groves	Orlando, FL
Christy's	Ellwood City, PA
Chrysler Corporation	Highland Park, MI
Citicorp	New York, NY

Citizens for a Sound Economy	Washington, DC
Clark Seals, Ltd.	Tulsa, OK
Claseman Management Services	St. Paul, MN
Climatic Control Company, Inc.	Milwaukee, WI
Coalition of Service Industries, Inc.	Washington, DC
Coca Cola, Co.	Washington, DC
Colborn's	Billings, MT
Coleco Industries, Inc.	West Hartford, CT
Columbia Chocolates By Mordens	Astoria, OR
Comdisco, Inc.	Rosemont, IL
Commercial Design Consultants	Milwaukee, WI
Committee for Small Business Exports	Aspen, CO
Comp-U-Card International, Inc.	Stamford, CT
Competition Cams, Inc.	Memphis, TN
Competitive Enterprise Institute	Washington, DC
Computer & Business Equipment Manufacturers Association	Washington, DC
Computer & Communications Industry Association	Washington, DC
Conco Systems, Inc.	Verona, PA
Concord Engineering, Inc.	Richmond, CA
Concord, Inc.	Fargo, ND
Consolidated Freightways, Inc.	Menlo Park,CA
Contact Systems Corporation	New York, NY
Control Data Corporation	Minneapolis, MN
Cooper Industries, Inc.	Houston, TX
Coopers & Lybrand	New York, NY
Copyright Clearance Center	Salem, MA
Creative Management Concepts	Reading, PA
Curtin Insurance Agency, Inc.	Cambridge, MA
Curtis Circulation Company	Hackensack, NJ
Custom Engineering, Inc.	Englewood, CO
D&M Consulting & Brokerage, Inc.	Marshfield, WI
D-M-E Company	Madison Heights, MI
Dawg Luvers & Co.	Jesup, GA
Deering Lumber, Inc.	Biddeford, MA
Design & Manufacturing Corporation	Connersville, IN
Di-Rec Services	Dallas, TX
Distilled Spirits Council of the U.S., Inc	Washington, DC
Dollar Power Discount Store	San Francisco, CA
Dolphin Photo Center, Inc.	Bend, OR
Donaldson Company, Inc.	Minneapolis, MN
Dow Chemical, U.S.A.	Midland, MI
Dow Corning Corporation	Midland, MI
Dunkin' Donuts Incorporated	Randolph, MA
E. H. Curtin Insurance Agency	Cambridge, MA
E. I. du Pont de Nemours & Co.	Wilmington, DE
E. J. Kearney & Company	Portland, ME
E. R. Clarke Associates, Inc.	Lake Forest, IL
Eastern Building Material Dealers Assoc.	Media, PA
Eastman Kodak Company	Rochester, NY
ERA Steel Construction Corp.	White Plains, NY
Echlin Corp.	Branford, CT
Eclipse, Inc.	Rockford, IL
Econocorp, Inc.	Randolph, MA

Elbert Bradshaw Enterprises	Carmel, IN
Electro Rent Corporation	Santa Monica, CA
Emergency Committee for American Trade	Washington, DC
Enerco Technical Products, Inc.	Cleveland, OH
Ernst & Whinney	New York, NY
Ernst & Whinney International	New York, NY
Esselte Business Systems, Inc.	Garden City, NY
Event Specialists, Inc.	Anchorage, AK
Executive Report	Pittsburgh, PA
FMC Corporation	Chicago, IL
Fairchild Industries	Chantilly, VA
Fila Associates	Miami, FL
First Bank System	Minneapolis, MN
Flambeau Corporation	Baraboo, WI
Fleetwood Enterprises, Inc.	Riverside,CA
Flint Industrial Services	Albany, GA
Focus Electronics, Inc.	Brooklyn, NY
Ford Motor Company	Dearborn, MI
Fort Howard Paper Company	Green Bay, WI
Fraser Paper, Limited	Madawaska, ME
Fred Jones Manufacturing Company	Oklahoma City, OK
Fuqua Industries, Inc.	Atlanta, GA
G.D. Searle & Co.	Chicago, IL
Garrett Corporation	Torrance, CA
Gates Lear Jet Corporation	Tucson, AZ
Gatherings South, Inc.	Greenville, SC
Gene Boyer & Associates, Inc.	Beaver Dam, WI
Genentech, Inc.	S. San Francisco, CA
General Dynamics Corporation	St. Louis, MO
General Electric Company	Fairfield, CT
General Public Utilities Corporation	Parsippany, NJ
Gerber Industries, Inc.	St. Peters, MO
Glowacki Everhardt & Association, Inc.	Toledo, OH
Goldman Sachs	New York, NY
Goodyear Tire & Rubber Company	Akron, OH
Gorman-Rupp Co.	Waterbury, CT
Grand Trunk Western	Detroit, MI
Greater Newark Chamber of Commerce	Newark, NJ
Gregory Manufacturing Co., Inc.	Jackson, MS
Griffin Agency	Prospect, PA
Grit Publishing Company	Williamsport, PA
Grumman Corporation	Bethpage, NY
HMA International Business Development, Ltd.	Greensboro, NC
Half Price Books, Inc.	Dallas, TX
Hamilton Beach, Inc.	Waterbury, CT
Heat - Timer Corporation	Fairfield, NJ
Helene Curtis Industries	Chicago, IL
Hercules Engines, Inc.	Canton, OH
Herrmidifier Company, Inc.	Lancaster, PA
Hevi-Haul International Limited	Butler, WI
Hexagon Architecture Group Limited	Wyncote, PA
High-Tech International	Beltsville, MD
Hill & Associates	Madison, WI
Hoffman Air & Filtration Systems	East Syracuse, NY

Holiday Corporation	Memphis, TN
Holloman Child Development Centers	Hampton, VA
Honeywell, Inc.	Minneapolis, MN
Horizon Resources Corporation	York, PA
Hotwatt, Inc.	Danvers, MA
Hunt Tractor, Inc.	Louisville, KY
ITBR, Inc.	Austin, TX
Illinois Lumber & Material Dealers Assoc.	Springfield, IL
Illinois Small Businessmen's Assoc.	Chicago, IL
Image Express	Southfield, MI
Imperial Schrade Corporation	New York, NY
Impressive Advance & Litho, Inc.	Waynesboro, VA
Incom International, Inc.	Pittsburgh, PA
Independent Bakers Association	Washington, DC
Industrial Commission of Arizona	Mesa, AZ
Industrial Heating Equipment Association	Arlington, VA
Informerific/Hexter & Associates	Cleveland, OH
Intel Corporation	Santa Clara, CA
International Business Aviation Council, Ltd.	Washington, DC
International Business Machines Corp.	Armonk, NY
International Data Corporation	McLean, VA
International Franchise Association	Washington, DC
Interstate Electronics Corporation	Anaheim, CA
JGP Marketing Group International, Inc.	Livonia, MI
JLG Industries, Inc.	McConnellsburg, PA
Jack O'Connor's Quality Beef 'N Seafood	Bridgewater, NJ
Johnson & Higgins	New York, NY
Johnson & Johnson	New Brunswick, NJ
Jon Holtshopple & Associates	Madison, WI
Judith E. Meador	St. Louis, MI
Justin Boot Company	Fort Worth, TX
Katy Industries, Inc.	Elgin, IL
Kentucky Manufacturing Co.	Louisville, KY
Kerr-Hays Co.	Ligonier, PA
Kimball Physics, Inc.	Wilton, NH
Kingsbury Machine Tool Corporation	Keene, NH
Knape & Vogt Manufacturing Company	Grand Rapids, MI
Knoll International Holdings, Inc.	New York, NY
Koch Industries	Wichita, KS
Koester Corporation	Defiance, OH
L.R. Nelson Corporation	Peoria, VA
LC Technologies, Inc.	Fairfax, VA
Lafarge Corporation	Dallas, TX
Lamanite Enterprises Corp.	Clearfield, UT
Lancaster Laboratories, Inc.	Lancaster, PA
Laramy Products Co.	Lyndonville, VT
Lavelle Aircraft Co.	Philadelphia, PA
Lee, Theisen & Stegall	Phoenix, AZ
Lennox Industries Inc.	Dallas, TX
Lewis Ranches	Portland, OR
Lin-Art, Ltd.	Arlington Heights, IL
Litton Industries	Woodland Hills, CA
Longyear Company	Minneapolis, MN
Louisiana Association of Business and Industry	Baton Rouge, LA

Louisiana Retailers Association	Baton Rouge, LA
Louisville Plate Glass Company	Louisville, KY
Lowe's Companies, Inc.	North Wilkesboro, NC
Luken's General Industries, Inc.	St. Louis, MO
Luken's Inc.	Coatesville, PA
Lumbermen Associates, Inc.	Philadelphia, PA
M. Brown & Sons, Inc.	Bremen, IN
M. S. Hansson, Inc.	Boulder, CO
MDB, Inc.	Pittsburgh, PA
Mack Trucks Inc.	Allentown, PA
Macmillan, Inc.	New York, NY
Maidenform, Inc.	New York, NY
Maine Machine Products Company	South Paris, ME
Maine Wild Blueberry Company	Machias, ME
Manufactured Buildings Components, Corp.	East Lansing, MO
Marco Wood Products	Walled Lake, MI
Margaret Coleman Associates	Hinsdale, IL
Marketing Communications Systems	Portland, OR
Markets Abroad, Inc.	Miami, FL
Marriott Corporation	Washington, DC
Marsh & McLennan, Inc.	New York, NY
Marshall & Associates	Topsfield, MA
Mary Kay Cosmetics	Dallas, TX
Mattel, Inc.	Hawthorne, CA
Mayflower Transit, Inc.	Indianapolis, IN
Maytag Corporation	Newton, IA
McIntosh, Inc.	Norfolk, NE
McLaurin Parking Co.	Raleigh, NC
McMinnville City Sanitary Service, Inc.	McMinnville, OR
Measurex Corporation	Cupertino, CA
Mel Boldt & Association	Mt. Prospect, IL
Mentholatum Company	Buffalo, NY
Merck & Co., Inc.	Rahway, NJ
Metal Treating Institute	Jacksonville Beach,FL
Metropolitan Life Insurance Company	New York, NY
Mid-Continent Cold Storage Co.	Omaha, NE
Milbar Corporation	Chargin Falls, OH
Miller Picking Corporation	Johnsontown, PA
Minnesota Mining & Manufacturing Company (3M)	St. Paul, MN
Mobil Oil Corporation	New York, NY
MonArk Boat Company	Monticello, AR
Morgan Guarantee	New York, NY
Morton Buildings, Inc.	Morton, IL
Mosbacher Energy Company	Houston, TX
Mosler International	Hamilton, OH
Murphy Oil Corporation	El Dorado, AR
N. J. Chapter - National Association of Women Business Owners	Cherry Hill, NJ
NVRyan	Alexandria, VA
Nalco Chemical Company	Naperville, IL
National American Wholesale Grocers Association	Falls Church, VA
National Association of Beverage Importers, Inc.	Washington, DC
National Association of Home Builders	Washington, DC

National Association of Manufacturers	Washington, DC
National Association of Photographic Manufacturers	Harrison, NY
National Association of Printing Ink Manufacturers	Harrison, NY
National Association of Women Business Owners	Chicago, IL
National Federation of Independent Business	Washington, DC
National Foreign Trade Council	New York, NY
National Frame Builders Association	Kansas, City, MO
National Gypsum Company	Dallas, TX
National Hispanic Business Association	Chamblee, GA
National Lumber & Building Materials Dealers Association	Washington, DC
National Machine Tool Builders Association	McLean, VA
National Retail Merchants Association	Washington, DC
National Small Business United	Washington, DC
National-American Wholesalers Grocers' Association	Washington, DC
Nestle Enterprises, Inc.	Solon, OH
New Jersey Small Business Unity Council	Little Silver, NJ
Newlyweds Foods, Inc.	Chicago, IL
Nicholson, Inc.	Helena, MT
North Haven Gardens	Dallas, TX
Northeastern Retail Lumbermen's Association	Rochester, NY
Northland Corporation	Greenville, MI
Northwest River Supplies, Inc.	Moscow, ID
O'Brien Communications	Del Mar, CA
Oakes & McClelland Company	Greenville, PA
Oakwood Markets, Inc.	Kingsport, TN
Occidental Chemical Corp.	Dallas, TX
Occidental Petroleum Corporation	Los Angeles, CA
Ogilvy & Mather	WAshington, DC
Oneida Ltd.	Oneida, NY
PC Etcetera	New York, NY
PII Affiliates, Ltd.	Manchester, PA
PLM Companies, Inc.	San Francisco, CA
PMI/Taylor Advertising	Columbus, OH
Pacer Systems, Inc.	Billerica, MA
Pacific Interstate Company	Los Angeles, CA
Pacific Northwest International Trade Association	Seattle, WA
Paragon Electric Company, Inc	Two Rivers, WI
Parlette Tire Co., Inc.	Erie, PA
Peat Marwick Main & Co.	New York, NY
Pennwalt Corporation	Philadelphia, PA
People to People Associates	Lexington, MA
Pepsi-Cola International	Somers, NY
Perham Egg, Inc.	Perham, MN
Perlis Truckstops	Cordele, GA
Pet Incorporated	St. Louis, MO
Pharmaceutical Manufacturers Association	Washington, D.C.
Philips Industries, Inc.	Dayton, OH
Picken Parts, Inc.	Fresno, CA

Pillsbury Company	Minneapolis, MN
Plabell Rubber Products, Inc.	Toledo, OH
Plasma Energy Corp.	Raleigh, NC
Plasco, Inc.	Woburn, MA
Ply*Gem Industries, Inc.	New York, NY
Polaris Industries, Inc.	Minneapolis, MN
Polaroid Corporation	Cambridge, MA
Powermax, Inc.	Columbus, OH
Pratt & Lambert	Buffalo, NY
Pre-Paid Legal Services	Ada, OK
Precision Twist Drill Co.	Crystal Lake, IL
Prinova Co., Inc.	San Francisco, CA
Printing Industries of America	Arlington, VA
Procter & Gamble	Cincinnati, OH
Product Development Corporation	Little Rock, AR
Professional Service Corporation	Green Bay, WI
Professional Wealth Management, Inc.	Asheville, NC
Professional Women in Construction & Allied Industries	White Plains, NY
Progressive Management Enterprises, Ltd.	St. Louis, MO
Pulp & Paper Machinery Manufacturers' Association	Washington, DC
Queen Carpet Corporation	Dalton, GA
Queen City Industries, Inc.	Piqua, OH
Quick, Finan & Associates, Inc.	Washington, DC
Quill Corporation	Lincolnshire, IL
R. R. Accessories, Inc.	Boston, MA
R. R. Donnelley & Sons Company	Chicago, IL
RJR Nabisco	Winston-Salem, NC
Radio KDNO	Delano, CA
Ramada, Inc.	Phoenix, AZ
Recognition Equipment, Inc.	Dallas, TX
Recon/Optical, Inc.	Barrington, IL
Rexnard, Inc.	Brookfield, WI
Rheem Manufacturing Company	New York, NY
Ridenour & Associates	Chicago, IL
Riordan, Crivello, Carlson & Menthkowski	Milwaukee, WI
Roll-o-Matic, Inc.	Kansas City, MO
Rooney, Plotkin & Willey	Providence, RI
Rorer International Pharmaceuticals	Fort Washington, PA
Rotron Engineering Company, Inc.	Woburn, MA
Rudolph Beaver, Inc.	Waltham, MA
Rural Gravuce Services, Inc.	Madison, WI
Russ Berrie and Company, Inc.	Oakland, NJ
S. C. Johnson & Son, Inc.	Racine, WI
SNC Manufacturing Company	Oshkosh, WI
Sabre Yachts	South Casco, ME
Safeway Stores, Inc.	Oakland, CA
Samsonite Corporation	Denver, CO
Sandmeyer Steel Company	Philadelphia, PA
Sargent-Welch Scientific Company	Skokie, IL
Scientific-Atlanta, Inc.	Atlanta, GA
Scott Paper Company	Philadelphia, PA
Sears, Roebuck and Company	Chicago, IL

Shaw Mudge & Company	Stamford, CT
Shell Oil Company	Houston, TX
Sheridan & Fritz, P.C.	Harrisburg, PA
Siliconix Inc.	Santa Clara, CA
Simplex Time Recorder Company	Gardner, MA
Singer, Lewak, Greenbaum & Goldstein	Los Angeles, CA
Smada, Inc.	Phoenix, AZ
Small Business Foundation of America	Boston, MA
Small Business Hawaii, Inc.	Honolulu, HI
Small Business United of Missouri	St. Louis, MO
Smaller Business Associates of New England	Boston, MA
Smaller Manufacturers Council	Pittsburgh, PA
Smith Barney, Harris, Upham & Co., Inc.	New York, NY
Smith Rollinson	Alexandria, VA
Snyder General Corporation	Dallas, TX
Southern Connecticut Gas Company	Bridgeport, CT
Spacesaver Corporation	Fort Atkinson, WI
Specialized Carriers & Rigging Association	Alexandria, VA
Square One, Inc.	Madison, WI
Squibb Corporation	Princeton, NJ
Sta-Rite Overseas Corporation	Milwaukee, WI
Standard-Thomson Corporation	Waltham, MA
Standard Oil	Washington, DC
Stemco, Inc. Truck Products	Longview, TX
Steiner Shipyard, Inc.	Bayou La Batre, AL
Stiegler, Inc.	Fargo, ND
Stone & Webster Engineering Corporation	Boston, MA
Storage Technology Corporation	Louisville, CO
Stripling-Blake Building Lumber Co., Inc	Austin, TX
Sun Electric Corporation	Crystal Lake, IL
Superior Technical Ceramics Corp.	St. Albans, VT
Syntex Corporation	Palo Alto, CA
T&H Building Supply	Redwood City, CA
TAPJAC Home Centers	Carthage, MO
TRW, Inc.	Cleveland, OH
TVI Creative Specialists	Washington, DC
TXI Industries	Dallas, TX
Tandem Computers Incorporated	Cupertino, CA
Tandy Brands, Inc.	Fort Worth, TX
Tanner Systems, Inc.	Sauk Rapids, MN
Tatum Enterprises	Honolulu, HI
Technivest, Inc.	South Bend, IN
Ted Grob Sales, Inc.	Grafton, WI
Tenneco Gas Pipeline Group	Houston, TX
Termiflex Corporation	Merrimack, NH
Terry Neese Personnel Services	Oklahoma City, OK
Texas Industries, Inc.	Dallas, TX
The Afro/Hispanic-American Chambers of Commerce	Bossier City, LA
The Americas Society	New York, NY
The Andersons	Maume, OH
The Black & Decker Corp.	Towson, MD
The Buffalo News	Buffalo, NY
The Calvert Gallery	Washington, DC
The Carlton Group	Richmond, VA

The Coca-Cola Company	New York, NY
The Collectors Guild Ltd.	Wilmington, NC
The Firestone Tire & Rubber	Akron, OH
The First Boston Corp.	New York, NY
The Free Press Media Group	Hendersonville, TN
The Fur Vault, Inc.	New York, NY
The Harodite Finishing Co., Inc.	North Dighton, MA
The Hartz Mountain Corporation	Harrison, NJ
The Hoover Company	North Canton, OH
The Krughoff Company	Naperville, IL
The Moser Bag & Paper Co.	Cleveland, OH
The New England Council, Inc.	Boston, MA
The Pillsbury Company	Minneapolis, MN
The Price Company	San Diego, CA
The Principal Financial Group	Des Moines, IA
The Quillen Group	Groton, CT
The Singer Company	Stamford, CT
The Stackpole Corp.	Boston, MA
The Telemarketing Company	Chicago, IL
The United Illuminating Company	New Haven, CT
The Upjohn Company	Kalamazoo, MI
The Valspar Corporation	Minneapolis, MN
The Will-Burt Company	Orrville, OH
Thomas J. Seitz Co., Inc.	Racine, WI
Tingley Systems, Inc.	San Antonio, FL
Toledo Harbor Warehousing, Inc.	Toledo, OH
Touche-Ross	Washington, DC
Tracor, Inc.	Austin, TX
Trail King Industries, Inc.	Mitchell, SD
TransTech, Inc.	East McKeesport, PA
Tri-M Corporation	Kennett Square, PA
Triangle Research Development Corp.	Research Triangle Park, NC
Trinity Industries, Inc.	Dallas, TX
Trouble Shooters, Inc.	Omaha, NE
Truck Trailer Manufacturers Association	Alexandria, VA
Trucking Services, Inc.	Dearborn Heights, MI
U.S. Axle, Inc	Pottstown, PA
U.S. Bearings & Drives of CA, Inc.	Santa Clara, CA
U.S. Council for International Business	Washington, DC
USG Corporation	Chicago, IL
Ultrasystems, Inc.	Irvine, CA
Unilever United States, Inc.	New York, NY
United Illuminating Company	New Haven, CT
United Industries Inc.	Wichita, KS
Vanport Manufacturing, Inc.	Boring, OR
Village Green	Midland, MI
Virco Manufacturing Corporation	Torrance, CA
Vocational Rehabilitation Associates, Inc.	Eugene, OR
W.H. Brady Co.	Milwaukee, WI
W.R. Grace & Company	New York, NY
WIS, Inc.	Toledo, OH
Wainoco Oil Corporation	Houston, TX
Waldorf Corporation	St. Paul, MN

Warner Communications, Inc.	New York, NY
Wayer Corporation	Landover, MD
Western Publishing Company, Inc.	Racine, WI
Weyerhaeuser Company	Tacoma, WA
Whale Scientific, Inc.	Commerce City, CO
Whirlpool Corporation	Benton Harbor, MI
White Plains Iron, Inc.	New York, NY
Wholesale Florists & Florist Suppliers of America	Arlington, VA
William A. Price & Associates	Wheaton, IL
William H. Taylor & Company, Inc.	Allentown, PA
Wingspread Corporation	New York, NY
Women Entrepreneurs	Lincolnwood, IL
Women Featherbone Company	Gainesville, GA
Woodhead Industries, Inc.	Northbrook, IL
ZinYeast, Inc.	Marshfield, WI

National Governors' Association

John H. Sununu
Governor of New Hampshire
Chairman

Raymond C. Scheppach
Executive Director

H-7. U.S. - CANADIAN TRADE

The Governors support implementation of the Free Trade Agreement negotiated by the federal governments of the United States and Canada. Our support is contingent upon Canada and the U.S. doing nothing in the interim to violate the spirit of the explicit understanding affirmed in writing on January 2, 1988 to "exercise their discretion in the period prior to entry into force of the accord so as not to jeopardize the approval process or undermine the spirit and benefits of the Free Trade Agreement."

The agreement, while not fully addressing all issues relating to our bilateral trade, is expected to contribute to real growth in the economies of both signatories. It represents a positive step toward the open, competitive world trading system that we have endorsed. It provides for more timely and effective resolution of disputes between the two largest trading partners in the world.

Throughout the negotiations, the Office of the U.S. Trade Representative has sought our advice and made it a priority to keep us informed on progress. As the related legislation is developed and debated, we will continue to consult with the administration and Congress regarding its impact on state economies.

Emphasizing the importance of U.S. - Canadian relations, we will continue our meetings with the Canadian Premiers on issues of mutual interest, including options for greater trade cooperation between our two countries.

We believe that efforts should continue to be made to resolve those issues not fully addressed during the negotiations and that remaining inconsistencies with the General Agreement on Tariffs and Trade (GATT) rules should be vigorously pursued. We will work with Congress and the administration and within our states to minimize any adverse effects of the agreement.

The Governors have significant concerns about issues created or not fully resolved by the agreement and ask to be consulted as the implementing legislation or other measures are developed to ameliorate these problems.

The administration should enter into additional negotiations to address inequities regarding subsidies. Fair and open trade for all businesses requires resolution of the reality or perception of unequal treatment of certain industries due to differing national policies on subsidies.

Adopted February 1988.

The **CHAIRMAN**. Thank you very much.
Secretary Martin.

STATEMENT OF WILLIAM F. MARTIN, DEPUTY SECRETARY, DEPARTMENT OF ENERGY, ACCOMPANIED BY SCOTT L. CAMPBELL, DIRECTOR, OFFICE OF POLICY, PLANNING AND ANALYSIS, DEPARTMENT OF ENERGY

Mr. **MARTIN**. Thank you very much, Mr. Chairman. Ambassador Yeutter has summarized it very well.

Let me say that we, too, believe that energy is one of the most important parts of the Free Trade Agreement. I think it is particularly important considering the rocky road that we have traveled with the Canadians on the energy front during the 1970's, of which most of the members of this committee know better than I.

On both sides of the border there were controlled markets, regulated markets; occasionally we would get some gas from the Canadians, but sometimes it was twice the price that they allowed their own consumers.

Beginning in the early 1980's, I think there was recognition on both sides of the border that opening of the markets was more important. Consumers on both sides of the border could benefit through more open trade and, indeed, investment could flow more easily. Canada to a certain extent through FIRA and the NEP had discouraged investment in Canada by American firms.

So, really, for the last 5 years we have moved towards a free and open market. As Ambassador Yeutter said, we do not see a surge of imports into this country in the near term because basically we do have free trade.

What this Agreement does is to consolidate the gains of the last 5 years and bring about more certainty in the trading and financial environment in the years ahead.

There are five major energy provisions. To outline them briefly: First, this Agreement prohibits any tariffs, barriers, import quotas—no restrictions of any type.

Second, it emphasizes no price discrimination. Our consumers are going to get the same prices which Canadian consumers get from Canadian producers.

Third, there is some very strong language about proportionality in times of shortages during national emergencies. The Canadians cannot cut us back unilaterally. If they cut back, they have to cut back proportionately their own market as well as the export market. This is an extremely important provision from a national security perspective.

You are also well aware of the provision which allows 50,000 barrels a day of Alaska North Slope oil to move to Canada. Once again, given the sensitivity we know about the maritime industry, we negotiated that this would move on U.S. bottoms.

You are also well aware of the continued free trade in uranium which is called for by the agreement.

The Agreement also continues to allow energy investment incentives in each of our countries; but once again, as the Ambassador has said, if there are unfair trading practices, we do have remedies through countervailing duties and other measures.

Often this is called a bill for consumers, and there is no doubt that consumers do win very large. There are 90 million households out there. Most use electricity and gas, and, indeed, the fact that we have no price discrimination and have assuredness of supply is important to them.

Our energy-intensive energies are going to benefit. I think our utilities benefit because it provides them more options for meeting their future demands.

The case has been made, Mr. Chairman, that producers lose in this Agreement across the board. One of the things which I think we would like to talk about today is; is that the case?

Let us take the issue of natural gas, for example. We have compared subsidies on both sides of the border, and it is in a way comparing apples and oranges. I have never heard a producer say he is not for free trade, but I have heard them say they are for fair trade.

So today we are prepared, if you wish, at an appropriate time for Scott Campbell to go through the subsidies on each side of the border for the benefit of the committee.

Secondly, we think this actually helps natural gas producers because it gives consumers more confidence in gas. We think gas is an important source to back out imported oil over the future.

In the area of coal, I had two concerns when we saw this. Number one, do the Canadians enjoy for some reason unfair environmental pluses? We know that they are not currently required to install scrubbers on their power plants. So again, anticipating a question on this, we have an analysis as to the environmental regulations governing coal scrubbers on both sides of the border.

Another concern I would have is if, indeed, our own coal industry would be hurt by electricity imports. There again, we think we are going to need a lot more electricity in this next century, maybe 100 gigawatts by the year 2000. We think there is plenty of room for coal, and we think that the electricity imports which will come in from Canada might account for about 2 percent of that 100 gigawatts of needed capacity.

In the area of uranium, which is perhaps one of the most difficult areas, the Department of Energy for the last three years has determined that we have a nonviable uranium industry. This industry has gone from 20,000 workers down to 2,500.

Again, we have to ask ourselves: What is the major contributor to this? Our analysis shows it is partly due to the fact that we have not realized the nuclear power future that we had hoped to.

The next question becomes: Are Canadians unfairly subsidizing their uranium industry? Again, Mr. Chairman, we are prepared through a handout to examine subsidies and government's role in the uranium industry on both sides of the border to help the committee to decide if, indeed, we have a level playing field or not.

Another critical question is: Do we need a viable uranium industry for national security reasons? Again, we have looked at this, looked at the state of our stockpile, and we have an assessment on this.

We also have some comments, some good and some less positive, about Senator Domenici's bill, which we will certainly talk about if you wish.

Let me conclude by saying that this is a horribly complex issue. Today we are, as I said, prepared to talk about a number of issues and compare how Canada does business and how we do business to really decide. We are for free trade, but will the trade that comes about be truly free and fair, which I think really is key to our producers?

Thank you very much.

[The prepared statement of Mr. Martin follows:]

Prepared Statement of William F. Martin
Deputy Secretary
U.S. Department of Energy

before the

Committee on Energy and Natural Resources
United States Senate
Washington, D.C.
April 19, 1988

Contents

Summary and Overview 1

The Free-Trade Agreement:

Preserves the Gains Made in U.S.-Canada Energy Trade Relations 2
Ensures Free & Open Energy Trade Between the U.S. & Canada 3
Will Benefit U.S. Households 4
Will Benefit U.S. Electric Utilities 5
Will Benefit U.S. Industrial Energy Users 6
Will Assure Continued U.S. Access to Canadian Oil & Provide Canada With Alaskan Oil 7
Will Benefit Natural Gas Consumers & Producers 8
Will Not Harm the U.S. Coal Industry 9
Will Preserve Open Markets in Uranium 10
Will Promote National Security by Reducing Reliance on Imported Oil 11
Offers Substantial Economic Benefits 12

Chronology of the U.S.-Canada Free-Trade Agreement

March 1985	At the Shamrock Summit, President Reagan and Prime Minister Mulroney asked their trade officials to explore ways to reduce and eliminate existing trade barriers between the U.S. and Canada.
September 26, 1985	Prime Minister Mulroney formally requested that the U.S. and Canada examine the potential for negotiating a comprehensive *Free-Trade Agreement.*
December 10, 1985	President Reagan notified the Congress of his intent to enter into bilateral negotiations with Canada using *fast track* procedures.
June 17, 1986	U.S. and Canadian free-trade negotiators met for the first time in Ottawa.
October 3, 1987	President Reagan notified the Congress of his intent to enter into a *Free-Trade Agreement* with Canada.
December 9, 1987	U.S. and Canadian negotiators initialed a final text of the Agreement.
January 2, 1988	President Reagan and Prime Minister Mulroney signed the final text of the Agreement.
— 1988 —	***Implementing legislation & Congressional action...***
January 2, 1989	U.S.-Canada *Free-Trade Agreement* scheduled to take effect.

Summary & Overview

The U.S.-Canada Free-Trade Agreement is an historic agreement that will yield major benefits for the U.S. and Canadian economies, for U.S.-Canadian bilateral trade relations, and for the international trade regime. The energy section of the Agreement is one of its most important. Energy trade between the U.S. and Canada amounts to over $10 billion per year, the largest such bilateral trade in the world. Canada is our largest oil supplier and provides virtually all of our natural gas and electricity imports. While these volumes are a small fraction of U.S. needs, they provide an important margin of energy security. Canada also is an important market for U.S. energy exports, importing 16 million tons or $700 million worth of U.S. coal in 1987, 20 percent of U.S. coal exports.

The Free-Trade Agreement ensures that the U.S. and Canada can continue to enjoy unrestricted trade in energy, provides benefits to U.S. consumers and producers, and enhances our energy security. The Agreement:

- prohibits future restrictions on energy trade, such as quantity limits, import or export taxes, and minimum prices;
- ensures that U.S. consumers will be treated equitably with Canadian consumers;
- provides added assurance of supply in the event of disruptions;
- will lower costs to consumers, including our energy-intensive industries, and help make U.S. industry more competitive in world markets;
- will provide more certainty to producers and consumers, which should expand energy trade and be more conducive to energy investment; and
- will, over time, reduce U.S. oil imports by encouraging continued market penetration of Canadian and U.S. natural gas, and greater use of Canadian hydroelectric power.

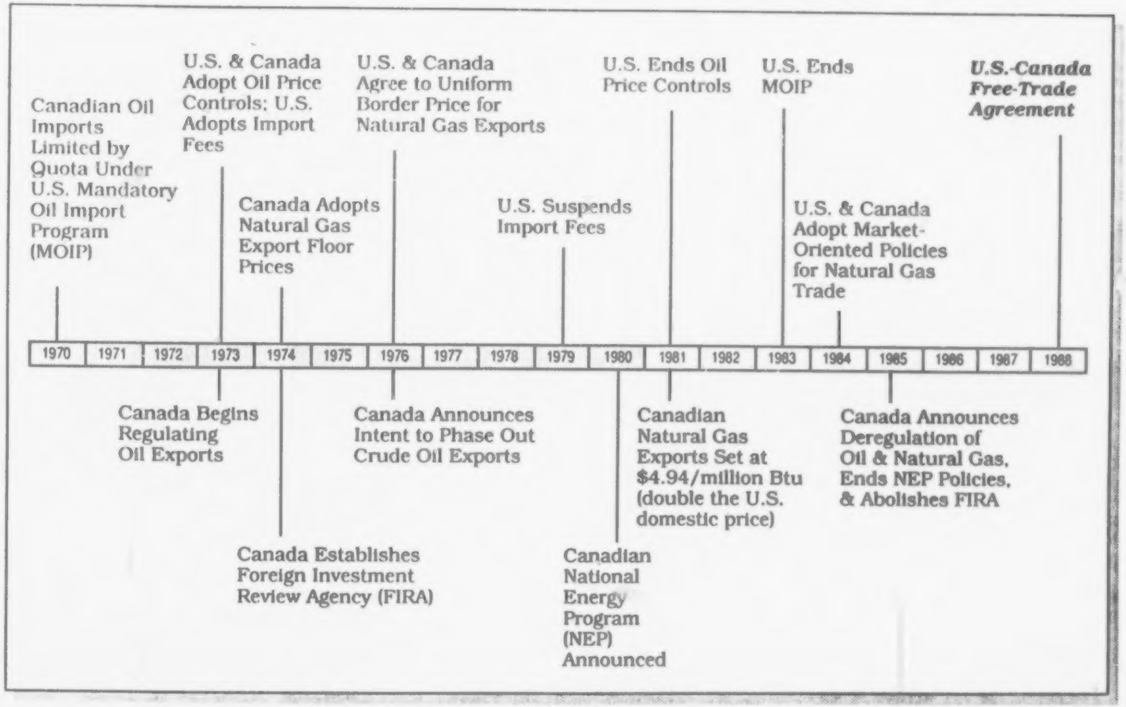
Consumers in the United States will benefit from this Agreement. The elimination of price discrimination in U.S.-Canadian energy trade will yield significant savings over time, particularly in electricity and natural gas. Greater assurance of unrestricted supplies of reasonably-priced energy will expand consumer choice and improve the likelihood of reducing oil imports. This will benefit millions of U.S. households, our energy-intensive industries, such as petrochemicals and primary metals, and our utility industry. The Agreement will not adversely affect domestic energy producers. By assuring consumers of secure Canadian gas supplies, the Agreement could expand opportunities for both U.S. and Canadian gas to penetrate new markets. It will ensure that our substantial coal exports to Canada are unimpeded, provide for the export of 50,000 bbl/day of Alaskan crude oil to Canada, and remove Canadian restrictions on uranium trade.

The Agreement will improve our mutual energy security. The U.S. may be importing 8-10 million bbl/day of oil by the mid-1990's, about one-half from the Persian Gulf. Canada also will face increasing vulnerability to disruptions in imported oil. The Free-Trade Agreement will help the U.S. diversify its trading patterns and import more energy from a secure and reliable trading partner. Moreover, by creating a stable framework for trade and investment, we will encourage greater development of U.S. and Canadian energy resources, and help reduce future dependence on the Persian Gulf.

The Agreement offers broad economic benefits. It will eliminate all remaining Canadian and U.S. tariffs, which still distort or impede our bilateral trade; eliminate many non-tariff barriers like quotas and minimum price requirements; secure access to Canadian markets for American manufacturing, agriculture, financial services, and high-technology; and set a standard for other international agreements such as the Uruguay round of multilateral trade negotiations.

The net result of the Free-Trade Agreement will be greater economic growth, more trade and investment, lower prices, and expanded employment opportunities for the U.S. and Canada. This is why President Reagan and Prime Minister Mulroney have called this a *"Win-Win"* situation – not just in energy but across the board.

History of U.S.-Canadian Energy Trade Relationship


Canadian Oil Imports Limited by Quota Under U.S. Mandatory Oil Import Program (MOIP)
U.S. & Canada Adopt Oil Price Controls; U.S. Adopts Import Fees
Canada Adopts Natural Gas Export Floor Prices
U.S. & Canada Agree to Uniform Border Price for Natural Gas Exports
U.S. Suspends Import Fees
U.S. Ends Oil Price Controls
U.S. Ends MOIP
U.S. & Canada Adopt Market-Oriented Policies for Natural Gas Trade
U.S.-Canada Free-Trade Agreement
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
Canada Begins Regulating Oil Exports
Canada Establishes Foreign Investment Review Agency (FIRA)
Canada Announces Intent to Phase Out Crude Oil Exports
Canadian National Energy Program (NEP) Announced
Canadian Natural Gas Exports Set at $4.94/million Btu (double the U.S. domestic price)
Canada Announces Deregulation of Oil & Natural Gas, Ends NEP Policies, & Abolishes FIRA

The Free-Trade Agreement Preserves the Gains Made in U.S.-Canada Energy Trade Relations

To put the Free-Trade Agreement in perspective, we have to review our energy trade relations with Canada over the last 20 years. Our energy trade policies have followed a rocky road, from policies based on protectionist and nationalistic objectives, to a relatively free and unrestricted market.

Until recent years, both the U.S. and Canada adopted policies that inhibited trade, discouraged development, and created shortages.

- The U.S. imposed oil import quotas and fees, domestic oil price controls, and an extensive oil allocation program.
- The U.S. natural gas market was also highly regulated during this time, leading to inflated demand and shortages.
- Canada restricted oil exports, taxed them, and priced them above domestic sales. It also regulated gas exports and prices, at one stage charging U.S. customers for its gas twice the average price of gas in the U.S. Canada also discouraged foreign investment in the development of its energy resources in its *Foreign Investment Review Agency* and *National Energy Program*.

These policies distorted and reduced energy trade, hurting both countries.

- Canada lost its attractiveness for foreign investment; saw a sharp decline in its oil production, turning temporarily from a net oil exporter to a net importer; and saw its U.S. gas sales fall.
- U.S. consumers lost because domestic demand was inflated, oil imports soared, and they were paying more for energy than Canadian consumers.
- Both countries also lost a degree of energy security because supply reliability was undermined and our dependence on Persian Gulf oil imports rose.

As we entered the 1980's, there was growing recognition by both countries that free trade and free markets offered tremendous economic advantages for both producers and consumers. This is why President Reagan eliminated oil price controls in 1981, and sought to deregulate much of the natural gas market. In this same spirit Canada moved to liberalize oil and gas export policies. In 1984, the U.S. and Canada adopted new policies for natural gas trade that were more compatible with changes in the energy markets, especially natural gas. These policies allowed exporters and importers to more freely negotiate contracts and prices.

In 1985, the Mulroney government announced several significant changes in energy policy. Oil and gas markets were largely deregulated. Oil export controls were eliminated and natural gas export regulations were eased further. Much of the discriminatory *National Energy Program* policies were eliminated and the *Foreign Investment Review Agency* was replaced by *Investment Canada* and a more favorable approach to foreign investment. Also in 1985, the U.S. removed controls on the export of domestic oil to Canada, except Alaska North Slope and Naval Petroleum Reserve oil. In 1987, the Canadian National Energy Board liberalized requirements for natural gas exports.

These positive actions led to reduced restrictions on investment and increased energy trade. The energy chapter of the Free-Trade Agreement preserves the gains we have made by removing market impediments and ensures that we will not return to the restrictive policies of the past.

The Free-Trade Agreement Ensures Free & Open Energy Trade Between the U.S. & Canada

- *Eliminates discriminatory pricing*
- *Ensures U.S. consumers are treated equitably with Canadian consumers*
- *Prohibits restrictions on imports and exports*
- *Provides added assurances of supply in the event of disruptions*
- *Liberalizes remaining trade restrictions:*

  –allows limited Alaskan crude oil exports to Canada
  –eliminates restrictions on Canadian uranium

- *Retains incentives for oil and gas exploration and development*
- *Provides for consultation on energy regulatory issues*

The Free-Trade Agreement Ensures Free & Open Energy Trade Between the U.S. & Canada

The Free-Trade Agreement consolidates the gains of the last five years and ensures that they will be maintained in the future. It includes provisions that:

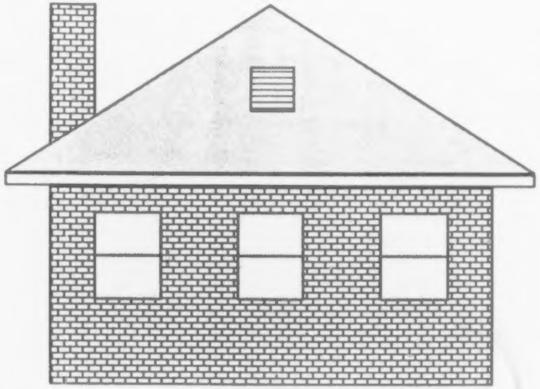
- eliminate discriminatory pricing in energy trade, assuring that consumers in both countries are treated equitably;
- prohibit restrictions on imports and exports, including quantitative limitations, import and export taxes, and minimum export prices;
- limit the circumstances under which one country may reduce imports from or exports to the other, which will help assure continuing energy supplies to consumers;
- allow for exporting up to 50,000 barrels per day of Alaskan crude oil to Canada – shipments to be carried from Alaska on U.S.-flag vessels;
- allow for free trade in uranium – Canada will eliminate its requirement that uranium exports be upgraded in Canada and the U.S. will continue its policy of not imposing restrictions on domestic enrichment of Canadian uranium;
- permit both countries to retain incentives for oil and gas exploration and development, in order to maintain our oil and gas resource base;
- protect U.S. producers from *unfair* Canadian subsidies – the U.S. retains the right to impose countervailing measures, should Canada unfairly subsidize its energy industry; and
- provide for bilateral consultations on energy regulatory actions to ensure they are not inconsistent with the principles of the Agreement.

The Agreement will preclude Canada from discriminating between Canadian and U.S. customers. Export restrictions will be allowed only if required to conserve energy resources, in connection with a price control program, or if there is a shortage. In any case, if such action is taken, similar action must be taken to proportionately reduce domestic consumption. Moreover, Canada cannot discriminate on price in implementing this Agreement. U.S. consumers will be guaranteed that Canadian energy supplies will be available to them on the same terms as they are to Canadian consumers, even during disruptions or shortages.

The Free-Trade Agreement includes a special energy trade provision which limits the circumstances under which either the U.S. or Canada may invoke national security as a justification for limiting energy trade with the other. Specifically, the Agreement defines *national security*, for the purposes of energy trade, as being restricted to meeting specified *military-related* requirements.

The U.S. depends on Canada for supplies of gas, oil and electricity. It is therefore important to ensure that the prices of these imports do not discriminate against U.S. consumers, and are as stable as possible in the event of disruptions. The Agreement will provide the U.S. with greater access to Canadian energy supplies, will limit the circumstances under which these supplies can be curtailed, will ensure that any curtailments are borne equitably by U.S. and Canadian consumers, and will eliminate discriminatory pricing. This access to secure Canadian supplies will be particularly important as our dependence on Persian Gulf oil grows in the future.

The Free-Trade Agreement Will Benefit U.S. Households



87 Million Households

- **Lower prices**
- **Assured supplies**
- **Displaced oil imports**

Source: U.S. Department of Energy

The Free-Trade Agreement Will Benefit U.S. Households

Of the approximately 87 million households in the United States, 15 million still use oil as their primary fuel, while 45 million use natural gas as their main fuel.

Oil dependence in the U.S. varies significantly by region. In the Northeast, oil provides 50 percent of residential requirements. Imports of Canadian electricity and natural gas have displaced imports of oil from other sources and saved consumers substantial amounts of money. In both the Northeast and Western U.S., Canadian hydroelectric power and natural gas have replaced more costly imported oil.

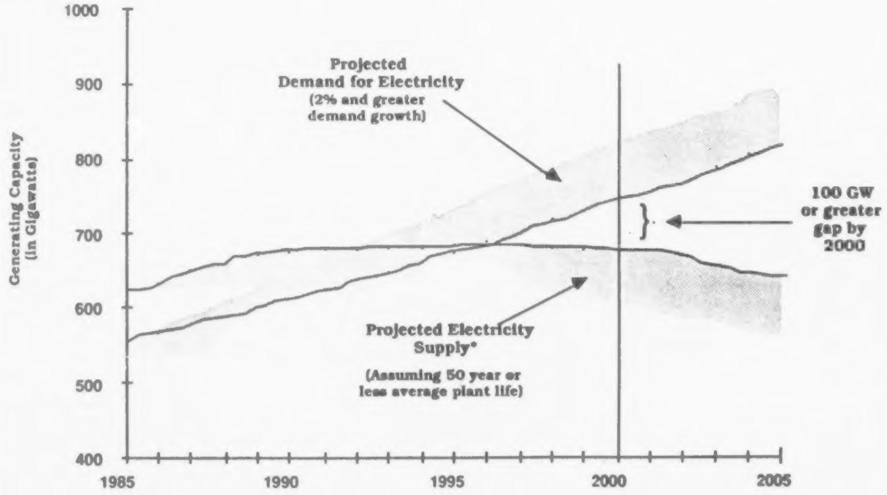
The Free-Trade Agreement has several provisions beneficial to U.S. households.

- Electric power imported from Canada will cost less because the Agreement will eliminate minimum price requirements.
- Price discrimination will be eliminated in the sale of Canadian electricity and natural gas to U.S. consumers.
- U.S. consumers will be assured of continuing supplies even during shortages.

There will be greater opportunity for displacing imported oil with Canadian hydroelectric power and greater use of natural gas from both U.S. and Canadian producers. Untapped Canadian hydropower potential is substantial, holding out the prospect of increased exports to regions of the U.S. that are highly oil-dependent, and thereby reducing oil imports into these regions from insecure foreign sources. Consumers should have more confidence in the availability of natural gas, which should encourage further penetration of both U.S. and Canadian gas in expanding U.S. gas markets.

U.S. Department of Energy preliminary estimates indicate that, over the long-term, natural gas could displace up to 1 million barrels per day of imported oil. This is good news for gas producers and consumers on both sides of the U.S.-Canada border.

Need for New Electricity Generating Capacity Expected to Grow Rapidly After 1995



* Existing plants plus plants under construction minus retirements.

Source: U.S. Department of Energy

The Free-Trade Agreement Will Benefit U.S. Electric Utilities

Even with the current surplus of generating capacity and continued improvements in the efficiency of electric power distribution and use, it is likely that substantial new generating capacity will be needed nationwide during the 1990's to ensure an adequate, efficient, secure, and reliable supply. Conservative estimates indicate that the U.S. will require 100 gigawatts of new electrical generating capacity – beyond plants now under construction – by the year 2000. Additional capacity will be needed in all U.S. regions. Such capacity can be created in a number of ways – using demand management, cogeneration, renewables, coal, nuclear power, gas-fired combustion turbines, and electricity imported from Canada.

Imported power from Canada accounts for less than 2 percent of all the electricity sold in the United States. However, it is an important power source in several regions:

- The Northeast imports hydroelectric power from Quebec, nuclear power from Ontario and New Brunswick, and coal-fired electricity from Ontario. New York receives about one-sixth of all its electricity from Canada. New England may be equally dependent on imported power by the mid to late-1990s.
- The Great Plains states use hydroelectric power from Manitoba.
- California uses hydropower from British Columbia, transmitted via the Pacific Northwest-Southwest Intertie.

Electricity imports from Canada have grown to about $1 billion per year and have saved consumers substantial sums of money. Many import contracts price electricity at 80 percent of the average cost of fossil-fueled generation by the importing utility. In the Northeast, this formula has produced cost savings of roughly 40 percent as hydroelectric imports from Canada have substituted for imported oil from abroad. Consequently, the typical residential electric bill in the Northeast has been cut by over a dollar per month.

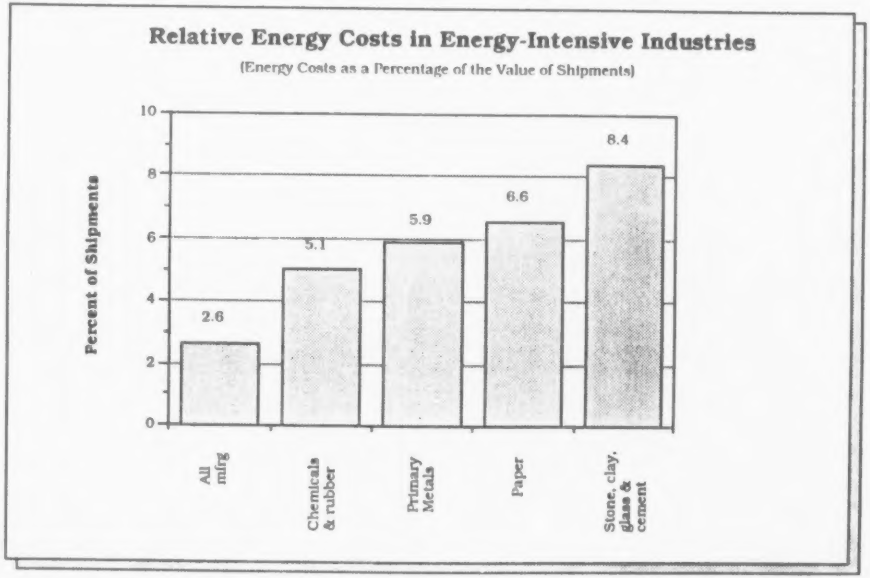
Roughly three-quarters of the Canadian power imported into the U.S. has displaced foreign oil. This imported electricity has made the U.S. 120,000 barrels per day less reliant on the Persian Gulf – a yearly savings of some $600 million on our bill for imported oil. Nationally, since the 1973 embargo, Canadian electric power imports have cost U.S. utilities some $7 billion *less* than their equivalent in imported oil.

The Agreement can help make Canadian electricity imports cheaper. Under current regulations, Canadian exporters may not charge a price for that electricity that is significantly less than the *least-cost energy alternative* available to their U.S. customers. While this has sometimes limited the negotiating power of U.S. customers relative to Canadian exporters, the Agreement will eliminate the *least-cost alternative* requirement.

The Agreement also will narrow the circumstances under which Canadian utilities may restrict deliveries of power under contract to U.S. utilities, thus making power imports more secure. It will ensure that Canada's requirement that electricity exports be *surplus* to Canadian needs is not used to prevent exports to the U.S. It also will ensure that any restrictions that *may* be imposed on exports will be proportional to overall Canadian supply restrictions. Moreover, Canadian electricity producers will be granted the same access as similarly situated U.S. utilities to the *Bonneville Power Administration's* interties, so hydropower from British Columbia may become more readily available to California.

The Free-Trade Agreement will serve to enhance the security of electricity supplies from Canada, improve the negotiating position of U.S. utilities, and reduce the cost of imports. It thus will help us meet our growing electricity requirements and keep our electric power system reliable.

Energy-Intensive Industries Should Benefit From Free-Trade Agreement



Relative Energy Costs in Energy-Intensive Industries

(Energy Costs as a Percentage of the Value of Shipments)

Source: U.S. Department of Energy

The Free-Trade Agreement Will Benefit U.S. Industrial Energy Users

The Free-Trade Agreement will benefit industrial energy consumers by:

- assuring non-discriminatory access to Canadian energy resources;
- increasing the availability of energy supplies, such as electricity and natural gas;
- improving security of supply by reducing circumstances under which supplies can be interrupted;
- reducing energy costs, over time, through enhanced supplies and more competitive pricing; and
- increasing the competitiveness of U.S. industries, such as our energy-intensive industries in world markets.

The U.S. industrial sector relies on oil to meet nearly 30 percent of its energy requirements. Some regions, such as New England and Florida, are even more dependent on oil due to capacity constraints on gas pipelines.

The Free-Trade Agreement, by providing non-discriminatory access to Canada's broad energy resource base, will allow industrial users to make purchasing decisions based on a longer-term, more secure supply horizon. Access to alternative sources of energy, such as natural gas and electricity, should result in greater consumption of these fuels by the industrial sector, thereby reducing reliance on oil from less secure sources. In addition, the Agreement should lead to lower energy costs by eliminating price discrimination in U.S.-Canada energy trade.

Lower energy costs will be of particular benefit to our *energy-intensive* industries, such as petrochemicals; primary metals; stone, clay, glass and cement; and paper and pulp. Average energy costs are less than 3 percent of the value of shipments for all manufacturers, but 5-8 percent for energy-intensive industries. Lower-cost energy can improve the competitive position of these industries in world markets.

Among the energy-intensive industries that will benefit from the Free-Trade Agreement are:

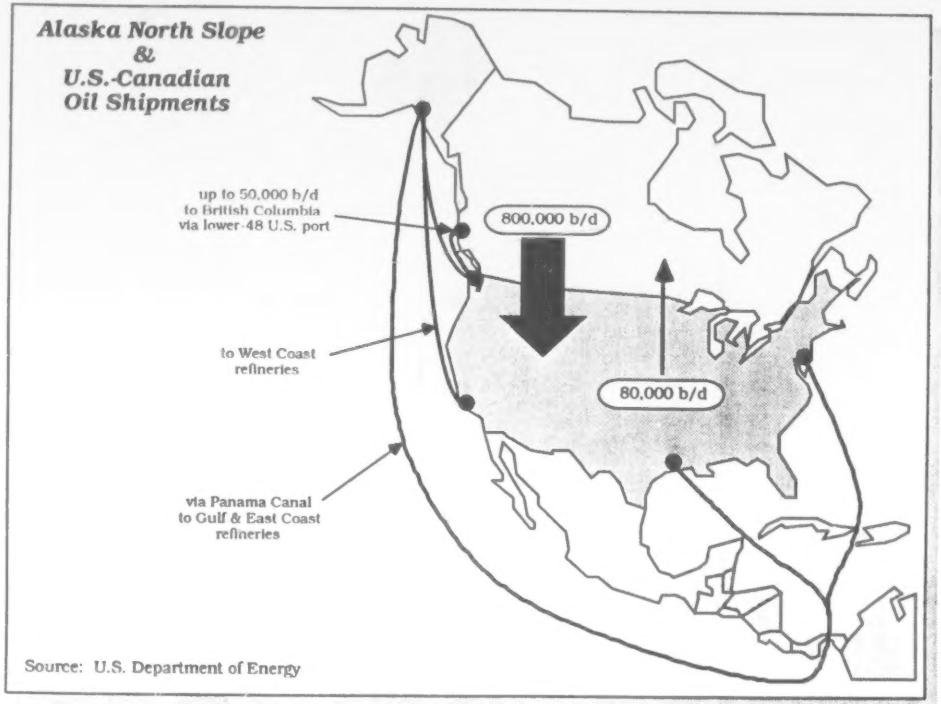
- **Primary Metals.** The high temperatures necessary to produce and shape primary metals require constant flows of energy. These industries in the past have faced shifting energy prices, interruptible energy flows, and intense international competition. The Agreement should mitigate these problems while enhancing the competitiveness of these industries.

- **Petrochemicals.** These chemical derivatives of oil and natural gas are created in highly energy-intensive processes. The industry will benefit from the increased supplies of energy for use as feedstocks, encourage the use of alternate boiler fuels to reduce this industry's overwhelming dependence on oil, and eliminate unfair competition from Canada that resulted from discriminatory pricing of energy exports.

- **Pulp and Paper.** Energy demand in this industry remains high. Since the paper industry is concentrated in the heavily wooded northern states that border Canada, this industry can benefit from proximity to new supplies and increased access to Canadian energy.

- **Stone, Clay, Glass and Cement.** Over half of the cost of cement production may be due to energy requirements. In the past, these industries have been under interruptible fuel contracts and suffered fuel curtailments. The long-term security of supply provided by the Agreement will allow this industry to make more efficient decisions regarding energy supplies.

The Free-Trade Agreement Will Assure Continued U.S. Access to Canadian Oil & Provide Canada With Alaskan Oil


Alaska North Slope
&
U.S.-Canadian
Oil Shipments
up to 50,000 b/d
to British Columbia
via lower-48 U.S. port
800,000 b/d
to West Coast
refineries
80,000 b/d
via Panama Canal
to Gulf & East Coast
refineries

Source: U.S. Department of Energy

The Free-Trade Agreement Will Assure Continued U.S. Access to Canadian Oil & Provide Canada with Alaskan Oil

Possibly the most significant aspect of the Free-Trade Agreement is that it preserves the progress made in U.S.-Canadian *oil* policy in recent years. Canada is our largest single supplier of oil, currently exporting about 800,000 barrels per day to the U.S. – 600,000 crude oil and 200,000 refined products. This secure source of supply will be particularly important to the U.S. during the next decade, as we become increasingly dependent upon imported oil.

The Agreement generally prohibits restrictions on imports and exports, including quantity limitations, import and export taxes, and minimum export prices. Neither the U.S. nor Canada may discriminate against suppliers or consumers in the other country, relative to its own domestic suppliers or consumers, in the pricing of energy supplies. Additionally, neither country may impose duties, taxes or charges on imported or exported goods that are not also imposed on the same products for domestic use. For one country to restrict energy exports, it must allow the other to receive its historically proportionate share of supply. Energy trade can be restricted for reasons of *national security*, but only in very narrowly defined circumstances.

Of greatest importance to the U.S. is Canada's commitment to allow the U.S. unrestricted access to Canadian oil supplies, even in the event of a disruption in world oil supplies. Under the Agreement, Canada will not discriminate between Canadian and U.S. oil users – in either price or supply quantities. In exchange for this commitment, the U.S. has agreed to provide Canada with access to limited supplies of Alaskan North Slope (ANS) crude oil, access not currently permitted under U.S. law.

A variety of laws and regulations restrict U.S. oil exports. The export of domestically produced crude oil, transported via the *Trans-Alaska Pipeline*, is effectively banned by the *Export Administration Act*. Other laws and regulations impose less severe restrictions on exports of crude oil produced in southern Alaska or the lower-48 states. Exports of refined products, generally, are not restricted.

The Free-Trade Agreement would amend the current prohibition on exports of Alaskan North Slope crude oil by allowing the export to Canada of up to 50,000 barrels per day of such oil, provided that it first is shipped to a port in the *lower-48* states. This will provide an additional supply of oil to refiners in British Columbia or eastern Canada. British Columbian refiners currently must buy either Asian oil or crude oil that has been transported across the Rockies. Thus, ANS crude oil may be an attractive alternative to other less conveniently located supplies.

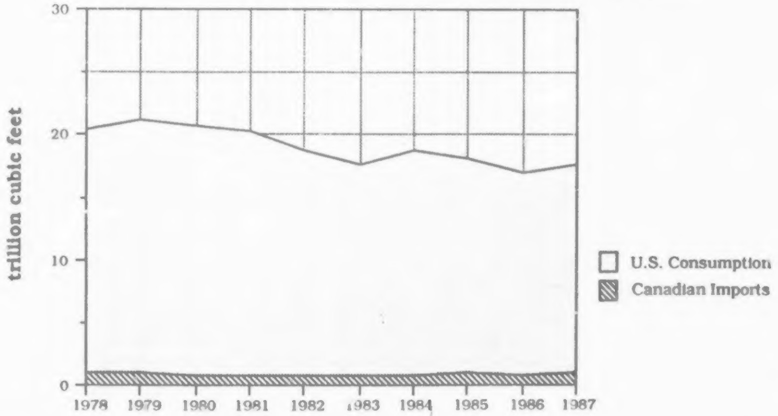
The requirement that ANS crude oil first must be shipped to a port in the *lower-48* states ensures the continued use of U.S.-flag tankers in transporting this oil, since shipments of oil between U.S. ports is required under the *Jones Act* to be transported on U.S.-flag ships.

Allowing exports of ANS oil to Canada will have little impact on U.S. consumers, since ample supplies of oil are available from alternative sources, such as Canada, Mexico, and Venezuela, which in many cases are closer to U.S. refineries. Any impacts of these exports are further restrained by the 50,000 barrel per day limit, which represents only 6 percent of our oil purchases from Canada, 3 percent of current ANS production and 0.3 percent of total U.S. oil consumption. In fact, these exports will have a similar positive impact to the current exports to Canada of crude oil produced in the lower 48 states. About 20,000 barrels per day of domestically produced crude oil currently is exported to Canada, resulting in transportation and other efficiencies for both Canadian and U.S. consumers. The U.S. also exports about 60,000 barrels per day of refined products to Canada.

Allowing exports of U.S. crude oil to Canada was a small concession to make when compared to the Canadian commitment to not restrict exports of oil and other energy sources to the United States. Canadian oil is important to the U.S. today, and it will continue to be important in the future.

Canadian Natural Gas Imports Are Comparatively Small, But Important to U.S.

Canadian Natural Gas Imports



Source: U.S. Department of Energy

The Free-Trade Agreement Will Benefit Natural Gas Consumers and Producers

Over the past 10 years, natural gas imports from Canada have accounted for about 4-5% of total U.S. gas consumption. 1987 gas imports increased to 900 billion cubic feet, or 5.4% of U.S. consumption. Irrespective of the Free-Trade Agreement, natural gas imports are expected to grow, roughly doubling by 1995. The bulk of Canadian gas imports go to the California and upper Midwest markets. Exports of gas from the U.S. to Canada are negligible.

The Agreement generally prohibits restrictions on imports and exports, including quantity limitations, import and export taxes, and minimum export prices. Neither the U.S. nor Canada may discriminate against suppliers or consumers in the other country, relative to its own domestic suppliers or consumers, in the pricing of energy supplies. Additionally, neither country may impose duties, taxes or charges on imported or exported goods that are not also imposed on the same products for domestic use. Several years ago, Canadian regulations required that the minimum price for exports be higher than prevailing prices to Canadian consumers. Canada has dropped this practice and the Free-Trade Agreement would ensure that such restrictions would not be imposed again. For one country to restrict energy exports, it must allow the other to receive its historically proportionate share of supply. Energy trade can be restricted for reasons of *national security*, but only under very narrowly defined circumstances.

The Agreement recognizes that incentives may be important to maintaining North American natural gas resources. However, the U.S.-Canadian countervailing duty laws will continue to apply if the domestic industry in one country is injured by subsidized natural gas imports from the other country. A new U.S.-Canadian panel, whose decisions would be binding as a matter of international law, would replace judicial review of administrative decisions in *subsidy* and *dumping* cases. Furthermore, the two nations have agreed to consult on energy regulatory actions which could result in discrimination inconsistent with the Agreement's principles.

We do not believe the Agreement reopens the FERC *"as-billed"* decision, or other previous FERC decisions. The Agreement's approach to potentially discriminatory regulatory rulings is to provide for consultations, or in the case of measures which one party alleges violates the Agreement, to allow that party to proceed through a dispute settlement process.

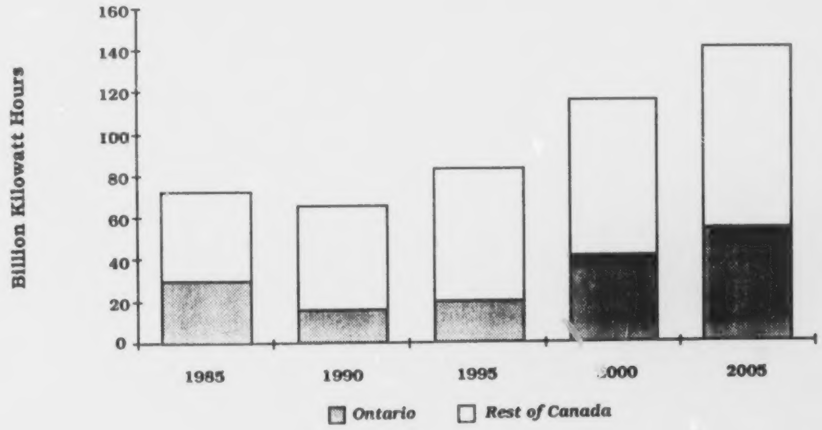
The Agreement should not have a direct effect on U.S. gas producers. In particular, the Agreement should not directly change the level of Canadian exports of natural gas because currently: (a) the Canadians are neither restraining exports nor discriminating against U.S. consumers in the price of natural gas exports, and (b) the U.S. is not restricting imports.

To the extent that ratification of the Agreement may bolster the confidence of gas users in the security of North American gas supplies, the Agreement may help expand gas markets for U.S. and Canadian gas producers. The Agreement will provide the U.S. with more secure access to Canadian energy supplies to meet our long-term energy needs, even in times of short supply. Such access to secure Canadian supplies will be particularly important as dependence on Persian Gulf and other OPEC energy supplies grows in the future. The commitments by Canada provide U.S. consumers with the assurance that their purchases of Canadian energy supplies will not be cut off in a discriminatory manner in the event of shortages.

Canadian and U.S. producers and consumers will benefit from the Agreement. We believe the Agreement can help troubled domestic gas producers by opening new markets for natural gas to all producers – U.S. and Canadian. The Agreement sends an important signal that plentiful supplies of natural gas will be available on both sides of the border. This should encourage expanded use of gas in several markets, including electric utilities. With more market-based influence and less government involvement in U.S.-Canadian gas trade, there also should be greater certainty about investment decisions.

Canadian Demand For Coal Is Projected to Increase in the 1990s & Beyond

Coal-Fired Generation in Canada



Source: U.S. Department of Energy

The Free-Trade Agreement Will Not Harm the U.S. Coal Industry

Canada is the largest single foreign market for U.S. coal. In 1987, 16 million tons, or 20 percent of U.S. coal exports went to Canada. This amount was rather evenly divided between *metallurgical coal* for Canadian steel smelters, and *steam coal* for electric power production in Ontario. While coal sales to Canada account for just 2 percent of U.S. production, they are vital to a number of coal companies. These coal exports have accounted for many jobs and significant income in Appalachia, as shown in Table 9-1.

Table 9-1: Effect of U.S. Coal Exports to Canada on Selected States in 1986

	Exports (million tons)	*Jobs*	*Income ($-million)*
West Virginia	7.4	1,900	230
Pennsylvania	4.5	1,300	140
Kentucky	2.8	700	70

The Free-Trade Agreement will assure an environment that is conducive to maintaining the coal industry's Canadian markets. The Agreement provides that there will continue to be neither tariffs nor other restrictions on coal exports to Canada. It should also forestall efforts to protect uncompetitive coal from Western Canada, the main competitor of U.S. *steam coal* for Ontario power production.

Some have argued that U.S. coal production is reduced because of U.S. imports of Canadian electricity. However, most such imports have replaced *foreign oil* and not *domestic coal*. In fact, a substantial portion of Canadian electricity exports to the U.S. are produced using U.S. coal. On balance, the net effect of electricity trade with Canada on U.S. coal production has been very small and is projected to remain so.

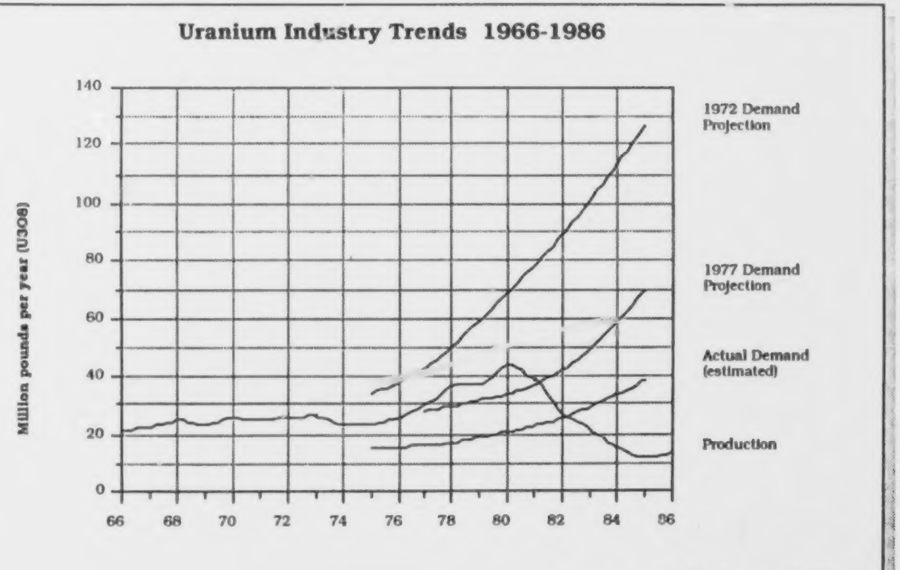
While opportunities for increasing coal exports to Canada are probably modest, the Free-Trade Agreement makes clear that U.S. coal companies can take advantage of these opportunities without fear of the rules changing. And in the longer term, the opportunities are very real. Ontario relies mainly on *nuclear* power for meeting its electricity needs, and new environmental regulations in that province may make it difficult to build new nuclear power plants beyond those are already planned. If this is the case, there would be expanded markets for U.S. coal in new and existing Canadian coal plants. As shown in the chart above, Canadian coal-fired generation is projected to grow substantially in the 1990s and beyond.

At the same time, the Free-Trade Agreement will not directly promote displacement of U.S. coal by Canadian electricity. A great deal of undeveloped Canadian hydropower is so economic that it could compete with new U.S. coal-fired electric power even if the U.S. and Canada had identical tax systems and capital markets. The Agreement cannot alter this fundamental economic reality, from which U.S. consumers stand to benefit. But, it does ensure that Canadian power will not be marketed in a discriminatory manner.

It is worth noting, as well, that coal remains a vital resource for electric power production in the United States. Canadian power, while often obtainable at advantageous prices, is a finite commodity that will not be available to the U.S. forever. Indeed, Canada's exportable electric power surplus could peak and start declining as early as the first decade of the next century. Moreover, there are many regions of the U.S. that have little or no access to even the Canadian power that is available. And, industry and government projections indicate that, in every region, new electric power supply beyond that now under construction will be needed in the 1990s.

Therefore, coal remains a vast and vital resource with excellent prospects for expanded markets domestically and internationally. Development of *clean coal technology*, transmission enhancements from coal-supplying regions to consuming regions, and more efficient environmental and zoning regulation all should contribute to enhancing these coal markets in the years to come.

Actual Uranium Needs Have Fallen Short of All Demand Projections



Source: U.S. Department of Energy

The Free-Trade Agreement Will Preserve Open Markets in Uranium

The uranium industry. The Secretary of Energy made determinations, as required by §170B of the *Atomic Energy Act of 1954*, that the domestic uranium mining and milling industry was not viable in 1984, 1985 and 1986. The decline of the U.S. uranium industry has progressed over a period of several years and is the consequence of several contributing causes, including:

- drastic downturn in the growth of domestic nuclear power and the resulting uranium inventory buildup;
- excess U.S. mining capacity and low nuclear plant capacity utilization; *and*
- the availability of richer grades of foreign ore.

As weaker firms exit the industry and inventory adjustments are made, we may find that the industry has become viable in 1987 or 1988.

Prior to the mid-1960s uranium was used primarily for military purposes and the federal government was the principal buyer. But with the growth of the civilian nuclear power industry, especially in the late-1960s and early-1970s, demand for uranium increased. Demand forecasts optimistically projected substantial growth well into the future. Because of restrictions imposed by the federal government, the U.S. imported no uranium for domestic use from (fiscal years) 1968 through 1974. By the mid-1970s, the domestic mining and milling industry was operating near full capacity, meeting then-current demand, and building substantial uranium inventories based on long-term commitments and projected growth.

Toward the end of the 1970s, however, it became apparent that U.S. demand for electricity, particularly nuclear-powered, was not going to reach projected levels. The escalation in nuclear power plant construction costs, reactor licensing complications, and growing public concerns about nuclear safety, led to cancellation of proposed or ordered nuclear-powered generating facilities, reducing further the expected demand for uranium. Furthermore, low nuclear plant capacity utilization factors resulted in lower than anticipated uranium consumption, and hence further reductions in demand.

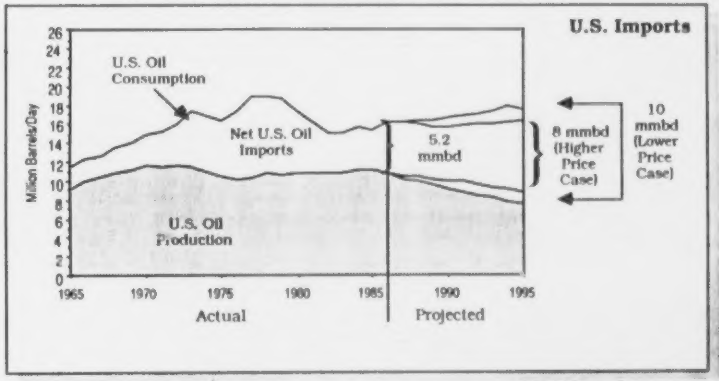
As a measure of the extent to which the uranium industry has declined, employment in exploration, mining, milling, and processing has fallen from a 1979 peak of 21,951 to only 2,120 in 1986, the latest year for which such data are available. In 1979, there were 362 underground and surface pit uranium mines operating in the U.S. – in 1986 there were 17. However, development of newer and more efficient techniques, such as in situ mining, have resulted in several new production facilities.

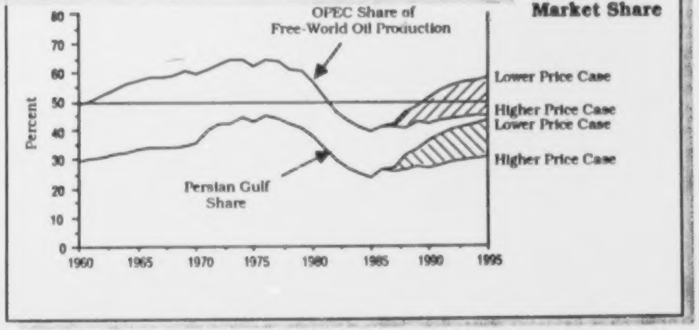
Although the issue is before the U.S. Supreme Court, the Department of Energy maintains that import restrictions would not provide significant relief to the industry to restore or assure its viability. What the uranium industry needs is a resurgence of the nuclear power industry's former growth, not protection.

Imports and the Free-Trade Agreement. Canada is the major foreign source of U.S. uranium, accounting for 65 percent of U.S. uranium imports in 1987. With the embargo on South African uranium, Canada's share of imports will likely increase. The U.S. exports no uranium to Canada. The Free-Trade Agreement will exempt the U.S. from the Canadian requirement that *uranium be upgraded in Canada to the maximum degree possible prior to export*. In return, Canada would be exempted from any future restrictions under §161(v) of the *Atomic Energy Act*, which provides that, to the extent necessary to assure maintenance of a viable domestic uranium industry, the Department of Energy shall not perform uranium enrichment services for foreign-source uranium for use in domestic reactors.

The Agreement will maintain Canada's free access to the U.S. uranium market, assuring domestic electric utilities – and their customers – of access to low-cost Canadian uranium. The Free-Trade Agreement would not change the market potential for domestic producers, since the current free trade in uranium would be maintained. U.S. converters will benefit by being able to bid on the conversion or upgrading of Canadian uranium purchased by both U.S. and foreign utilities.

The Free-Trade Agreement Will Promote National Security by Reducing Reliance on Persian Gulf Oil





Source: U.S. Department of Energy, Energy Security Report

The Free-Trade Agreement Will Promote National Security by Reducing Reliance on Imported Oil

Strengthening the Nation's energy security is a primary U.S. policy goal. Estimates show that U.S. net oil imports could rise to 8-10 million barrels per day by the mid-1990's and that our dependence on imports from the volatile Persian Gulf also could rise.

The Free-Trade Agreement will increase energy trade with Canada, a secure and reliable trading partner, and will help the U.S. reduce oil imports from less stable regions. Imports of oil, gas and electricity from Canada have already reduced our reliance on the Persian Gulf. The U.S. imported more than 800,000 barrels per day from Canada in 1987. Without this oil, our reliance on the Persian Gulf for imported oil could have been about 16 percent higher.

Over time, U.S. imports of Canadian natural gas and electricity could rise and the U.S. will continue importing Canadian crude oil, even though Canada expects to become a net oil importer in the 1990's. Moreover, the creation of a stable framework for long-term energy investment and trade between the two countries will be more conducive to energy development and trade expansion that will further help to displace oil imports from unstable regions.

The more energy we import from secure sources like Canada, the less dependent we will be on the Persian Gulf. The more energy the U.S. and Canada produce, the less oil the two countries will import. This is good news for energy security.

Enhancing energy security requires a number of steps:

- maintaining a strong domestic oil industry;
- increasing strategic oil stocks, both by the U.S. and our allies;
- expanding the availability of domestic oil and gas resources by permitting environmentally-sound exploration and development of promising areas like the Coastal Plain of the Arctic National Wildlife Refuge (ANWR);
- ensuring the viability of nuclear power through reauthorization of the *Price-Anderson Act* and nuclear licensing reform;
- continuing conservation and progress toward energy diversification;
- promoting efforts, like clean-coal technology, to enhance use of our domestic coal resources;
- removing barriers to energy trade and promoting development of secure energy sources worldwide through such efforts as the U.S.-Canada Free-Trade Agreement.

The Free-Trade Agreement with Canada is one important step toward greater energy security.

President Reagan and Prime Minister Mulroney on the U.S.-Canada Free-Trade Agreement

"Our Congress, as well as the Canadian Parliament, will review this agreement fully over the next several months. As this process begins, both sides should be mindful that the decisions they make will help shape the relationship between our countries in the years to come, and will send a signal to the rest of the world."

"The creation of the world's largest free trade area will be a mark of leadership and presents an historic opportunity to the United States and Canada. We must not let this opportunity slip from our grasp."

President Reagan, January 2, 1988

"This is an historic day for Canada and for the United States. The negotiation of a Free Trade Agreement between the world's largest bilateral trading partners is a significant achievement and constitutes a powerful signal towards liberalized trade around the world. In a world buffeted by the constraints of protectionism, all trading nations seek the safe harbor of more secure trading relationships."

"I am convinced that this Agreement strongly benefits both nations....It provides increased opportunity for trade, for investment and for growth."

Prime Minister Mulroney, January 2, 1988

The Free-Trade Agreement Offers Substantial Economic Benefits

The Free-Trade Agreement will eliminate, over a 10-year period, tariffs and most other trade barriers that presently distort or impede our trade with Canada. Canadian tariffs are significantly higher on average than U.S. tariffs. Their removal – as well as the removal of non-tariff barriers, such as quotas and minimum price requirements – should increase two-way trade and lower costs to consumers. The Agreement will have significant benefits for both the U.S. and Canada. Private studies have projected:

- increased economic growth;
- greater bilateral trade, projected in one survey as a $25 billion increase in two-way trade over a five-year period;
- thousands of new jobs for Americans; and
- enhanced U.S. competitiveness in world markets.

The Agreement will open tariff-protected Canadian markets to U.S. companies. Tariffs on such products as footware, furniture, paper, and textiles prevent full and equal participation by U.S. companies in the $385 billion Canadian economy. The Agreement also will improve trade opportunities for U.S. companies in automobiles, agriculture, and other major markets. For example, U.S. companies for the first time will be able to participate in the Canadian used car market.

U.S. companies will be able to use present plant capacity more efficiently by increasing production to meet demand from new or growing Canadian markets. Better use of production capacity can lead to increased productivity and lower unit costs. Many U.S. companies are using old and inefficient production facilities. Increased demand for U.S. goods can stimulate investment in new, more efficient capacity. The ability to produce lower-priced goods improves the competitiveness of U.S. industries, not only in the U.S. and Canada, but in markets throughout the world.

U.S. manufacturers also should benefit from better access to lower-cost inputs, ranging from energy to semifinished and manufactured products ready for assembly in the U.S. Lower-cost energy can improve the competitive position of energy-intensive industries such as petrochemicals, steel, aluminum, cement, and glass. Less costly components and subassemblies can improve the competitive position of U.S. manufacturing industries such as automobiles.

The Free-Trade Agreement also will demonstrate to other countries that we are serious about free and fair trade. It will provide a good model for other bilateral trading arrangements, as well as for our multilateral negotiations in the *General Agreement on Tariffs and Trade* (GATT). The U.S.-Canada Free-Trade Agreement can:

- influence other countries to further open their markets – countries not subject to the Agreement (and its benefits) will have added incentive to seek trade liberalization with the U.S. and Canada;
- serve as a model for the current round of GATT negotiations which seeks increased trade liberalization; and
- provide a good basis for dealing with investment, trade in services, and licensing requirements, issues which have not been fully dealt with in previous GATT rounds.

Canada and the U.S. have an historic opportunity to send the right message to the international community that freer trade in all areas is in everyone's interest.

The CHAIRMAN. Thank you very much.

Mr. Martin, I take it you are satisfied with the state of our uranium stockpile?

Mr. MARTIN. Mr. Chairman, we think our stockpile is capable of meeting defense needs for the next 30 years.

The CHAIRMAN. How much of that is enriched, and how much is to be enriched?

Mr. REINSTEIN. I believe that the stockpile of enriched uranium is——

The CHAIRMAN. I say enriched. I mean how much is in plutonium?

Mr. MARTIN. Ninety-five percent is not enriched.

The CHAIRMAN. The 5 percent that is is capable of meeting our needs for how long?

Mr. MARTIN. Without ongoing enrichment? I am assuming that we can enrich the uranium when we need it. We certainly have plenty of enrichment capacity at the moment. I do not see that as a constraint.

The CHAIRMAN. Do I read correctly, Mr. Yeutter, section 902(3)(a) as to permit an oil import fee should we desire to enact one? If that is not the correct section, is there another section that would so permit that?

Ambassador YEUTTER. I do not recall the precise section, Mr. Chairman, but I will respond to the substance of the question.

We would be in violation of the Free Trade Arrangement were we to enact an oil import fee. Now, we can enact whatever we wish in the United States. We are a sovereign nation, but if we were to do so it would trigger certain responses on the Canadian side of the border, of course. We can enact it, but we have an obligation to exempt Canada from that fee.

The CHAIRMAN. You would have to exempt Canada from that?

Ambassador YEUTTER. Yes, we would under the terms of the agreement.

The CHAIRMAN. All the talk we have had here about an oil import fee during the recent economic summit, we frankly came very close to it. We came back to the Senators and asked them whether they were for it as part of that package. By margins of 55 to 62, depending on how we packaged it, the Senators were for an oil import fee.

Now, they were not on the House side. Many people think that the last tax to be passed by this Nation has not yet been passed, and an oil import fee would be a very live candidate considering the very difficult position of our oil and gas industry, our domestic oil and gas industry.

Now, in one fell swoop of this agreement are we talking about doing away with the ability to pass that oil import fee?

Ambassador YEUTTER. Insofar as Canada is concerned, yes, sir.

It seems to me, Mr. Chairman, that is quite understandable from the standpoint of looking at the policy that is really embedded in a free trade arrangement. The idea is to try to remove restrictions in trade between the United States and Canada, remove them all if we could, rather than add new restrictions on trade between the United States and Canada. Whether it be an oil import fee or any other import fee, that would certainly be violative of the spirit of such an agreement.

The CHAIRMAN. I tell you, I hope we have gotten really a lot of good things outside of energy, because this looks pretty bad to me on energy.

Now, on present and future incentives, the Canadians preserve their future or present incentives, whatever those might be?

Ambassador YEUTTER. If you are talking about subsidies of various kinds, both countries retain the privilege of doing that so we can subsidize and they can subsidize, both of us, however, being subject to the countervailing duty laws and antidumping laws of the other country.

So we have protections against Canadian subsidies, and they have protections against our subsidies.

The CHAIRMAN. Do they have a protection against, say, our depletion allowance? What would they do if we wanted to export oil to their country? Would they knock off the depletion allowance, or what would they do?

Ambassador YEUTTER. I am not sure whether depletion allowance is countervailable. Maybe our lawyers can answer that question, Mr. Chairman.

Chip.

Mr. ROH. I am not sure, Senator, whether Canada would consider that to be a countervailable subsidy or not. If they did, they would have to show injury and all that as well.

I do not know the answer as to whether that would be regarded as a countervailable subsidy.

The CHAIRMAN. So that may be subject to countervailing duty laws?

Ambassador YEUTTER. Each relevant agency in the two countries must, as it does today, make a determination as to whether a particular subsidy is countervailable.

The free trade arrangement will not affect that situation at all. That situation is unaltered by the FTA.

The CHAIRMAN. But the speed at which they can get an answer with the new provisions here would be a lot faster, would it not?

Ambassador YEUTTER. No, because the provisions are exactly the same, Mr. Chairman, except for the review. Now whether the binational review at the end of the day will be any faster than a court review, I am not sure. The basic decision which involves, in our case, the U.S. International Trade Commission and the Commerce Department, will be the same.

The CHAIRMAN. I understand that the implementing legislation drafted by your staff is a classified document. Is that correct?

Ambassador YEUTTER. It is only a proposal at this point in time, Mr. Chairman, because as you probably know we have an agreement with our colleagues at the Senate Finance Committee and the House Ways and Means Committee that we will work with them in the drafting of the implement legislation.

So what has been done thus far is simply an effort to expedite the process by getting a draft done. That has no official status and will not have any because it is only for the purpose of getting the process moving.

We did that at the request of your colleagues in those particular committees.

The CHAIRMAN. If we made a similar request, would it be granted?

Ambassador YEUTTER. It would not cause us any difficulties. I am not sure whether it would cause your colleagues in those committees any difficulties or not, Mr. Chairman.

The CHAIRMAN. When do we get a chance to look at it?

Ambassador YEUTTER. Chip.

The CHAIRMAN. The staff advises me that the copy was just delivered, and it is in the safe. [Laughter.]

If anyone wants to look at it, you have to know the combination.

Senator DOMENICI. Do you have the combination, Mr. Chairman?

The CHAIRMAN. I do not, no. I do not know who does.

I have heard concern voiced as to whether the Canadian provinces will comply with the agreement.

What assurance have you gotten that they will comply?

Ambassador YEUTTER. From the very beginning of this exercise, Mr. Chairman, we have insisted that the Federal Government of Canada guarantee us that all elements of Canadian Government will carry out the provisions of this agreement as necessary.

Now, how the Canadian Federal Government obtains the cooperation and involvement of the Provinces when required is a challenge for them.

We have indicated from the beginning that we do not intend to practice Canadian constitutional law, and neither do we intend to negotiate with all the Provinces as well as with the Federal Government.

The CHAIRMAN. That is not really a fine point of Canadian constitutional law. It is very plain that the Federal Government in Canada, and I do not know whether you call it the Federal Government, the Central Government, simply does not speak for the provinces on those matters, do they?

Ambassador YEUTTER. There are only a few provisions of this agreement that require any provincial involvement at all. They are basically provisions involving alcoholic beverages, and it is possible that there may need to be some involvement in this area.

If there needs to be involvement by the provinces in this or any other area, it must take place. We expect the Prime Minister and his government to deliver on the commitments that are made in this agreement. How the Prime Minster does so and how the Federal Government of Canada does so is up to them. They must do so.

The CHAIRMAN. How do we know if they have?

Ambassador YEUTTER. How do we know? Well, we do not know with certainty on any agreement we negotiate with anybody in the world, but we have to assume when the Prime Minister signs this agreement that he will deliver. I am confident that he will do so.

The CHAIRMAN. The Soviet Union could not assume that when Jimmy Carter signed SALT II that he could deliver because we know we have a special process where the Senate ratifies.

Ambassador YEUTTER. Yes.

The CHAIRMAN. Now, do we know with respect to Canada that the Prime Minister cannot deliver for the Provinces? Would they be required to ratify as well?

That is a question. That is not an argument.

Ambassador **Yeutter**. I will ask Mr. Roh to give you a legal response to it, including the fact that if the Prime Minister is unable to deliver we have certain rights under the agreement itself.

Mr. Roh, would you please respond?

Mr. **Roh**. Sure.

Senator, under Article 103 of the agreement, the Canadian Federal Government and the United States Federal Government have an ironclad obligation to ensure observance of the obligations of the agreement by the states and the Provinces so that any provincial violation is actionable in the same way a Federal Government violation is.

Prime Minister Mulroney has said that Canada will do everything necessary to comply. Whether they will do that through Federal override, legislation, court action or what have you, I do not know. But he has said that they can deliver. There has obviously been a political debate in Canada, but whether that amounts to a serious constitutional problem in Canada I am just not sure.

The **Chairman**. John Turner, the liberal party leader, has been reported to claim that if the liberals win they will tear up the agreement and try to pass a new one. I am sure you have heard that.

What would you do if they did that? [Laughter.]

Ambassador **Yeutter**. Well, both parties have termination privileges under the agreement, so we can do the same thing from our standpoint if we choose. My judgment, however, is that once the agreement is implemented, it is most unlikely that either party will terminate it anytime soon because the merits of the agreement will be evident on both sides of the border.

I just happened to be in Canada over the weekend, Mr. Chairman, and someone raised that issue in Vancouver. The comment by a high-level official was to the effect that that kind of threat was simply unrealistic.

The **Chairman**. Mr. Yeutter, under 161(v) of the Atomic Energy Act, the Government is required to maintain a viable domestic uranium industry. I think they are going to oral arguments in the Supreme Court.

As you know, the lower court has ruled that action by the administration is required because of the administration's failure to live up to that provision. The Supreme Court entertains those oral arguments on Wednesday.

It would appear to me, therefore, that under present law the domestic uranium industry has effective provisions available to it which do not expire in the year 2001. They go on.

Now, considering that that is apparently the law at least, assuming that the Supreme Court will uphold it, which I do assume, if that is so, why is our provision in S. 2097 is not consistent with this trade agreement, considering that those subsidies fade out only when we get our industry back on its feet again?

Ambassador **Yeutter**. I will ask Mr. Reinstein to comment with greater specificity, but let me just give you a general answer, which would be that as in the earlier question that we had, this one, too, would be violative of the spirit of the agreement.

The intent here was to have free and open energy trade, and the particular provision to which you refer would be a derogation, if you will, from free and open energy trade. That is why it would be inconsistent with the spirit of the FTA as it was negotiated.

To be more specific, let me ask Mr. Reinstein to comment.

Mr. REINSTEIN. I think we probably ought to avoid commenting on the likely outcome of the Supreme Court case. Obviously the administration has a different view from the industry on this case and has taken the position that the mechanism provided in the law would not make the industry viable and, therefore, should not be implemented.

The fact of the matter, Senator, is that there have been no restrictions, direct or indirect, on the importation of uranium into the United States effectively restricting those imports since probably about 1980. We did restrict the enrichment of foreign uranium from 1967, and we phased out the last vestiges of those restrictions on January 1, 1984. We began phasing them out in 1977, and by 1980 they were really no longer restricting imports at all.

So we have really had 8 years now of unrestricted uranium imports.

The CHAIRMAN. Eight years of what the court would say is a violation of the law, would they not?

Mr. REINSTEIN. I think we are still waiting to see what the court's decision is.

The CHAIRMAN. The lower court's decision said that.

Senator DOMENICI. Mr. Chairman, would you just yield for an observation?

The CHAIRMAN. Yes, certainly.

Senator DOMENICI. I just want to share with you on your last question that it is incredible to me that our own negotiators maintain a position that they could not talk about the United States Supreme Court decision while they were negotiating with Canada. They said they could not talk about it, but they wrote a provision in that says the section that underpins that law is vitiated by this treaty.

It seems to me they talked very succinctly to it. They wiped it out. So they did not have to talk about it, they just did away with it.

That is one of the very few provisions where one of our laws is vitiated in this agreement, so I do not know what good it does to sit here and play cat and mouse, saying that we do not want to talk about the case, when as a matter of fact they wrote in the treaty that that law was no longer operative. It is the case that you are referring to. It is the statute that you are referring to that is pending.

Is it not true that you write it out with this bill? You say it shall not be operative?

Mr. REINSTEIN. We would exempt Canada from any restrictions that might be imposed under that provision of law. There are, in fact, no restrictions being imposed today.

Senator DOMENICI. You could not talk about the case but you could do that? I guess that is my question.

Mr. **Reinstein**. What we are saying is we are prepared to wait and see how the court rules because we do not take a position of how the court is going to rule at this point.

Senator **Domenici**. I thank you.

The **Chairman**. Thank you very much.

Now, in order of the way that the Senators came in, if I can remember it, I think Senator Bingaman is first.

Senator **Bingaman**. Let me ask a question on this issue. I mentioned in my opening statement involving FERC Opinion 256. We have a letter here that the Chairman read into the record from the Ambassador of Canada saying that the Canadian government does not view FERC's as-billed decision as being inconsistent with or affected by the Free Trade Agreement.

My information is that the former National Energy Board of Canada Chairman, Geoff Edge, filed expert testimony in a Pacific Gas transmission rate case before FERC stating that if the United States-Canada Free Trade Agreement were ratified, it would vitiate FERC Opinion 256 prohibiting as-billed flow through of Canadian gas costs.

I would be very interested in your view as to this matter and whether folks who would like to see 256 remain unaffected by the Free Trade Agreement can be assured that this will be the case.

Mr. **Martin**. Senator, from day one of this agreement we have said that we felt Order 256 was consistent with the Free Trade Agreement. I think Ambassador Gotlieb's is the official word of Canada, and I think it is encouraging that he would say that.

We do have a process under way of consultation on this particular issue. We have discussed it in great length with the Canadians. We feel very strongly about it. Indeed, we do think it is consistent.

Earlier the Chairman had mentioned what would be the effect on FERC and other regulatory bodies of the Free Trade Agreement, and I think it is fair to say the answer to that question is that anything decided by FERC or other regulatory authorities would have to be consistent with the Free Trade Agreement. In this case, we think 256 is.

I would like to ask Mr. Reinstein and Mr. Campbell, who both negotiated this with the Canadians, to comment if they would like.

Mr. **Reinstein**. We did, in fact, discuss this Opinion 256 during the course of the negotiations, and the resulting provision of the agreement that reflects the concerns is Article 905, which provides for consultations if either country believes the other country's energy regulatory actions are discriminatory.

Clearly, that applies to future actions, and it provides for consultation. It does not provide for change in any regulation. It opens up an avenue of enhanced communication in the complex area of energy regulation. That is the only provision in the agreement, we believe, that has any bearing on decisions of the kind that Opinion 256 is, and it does not apply to Opinion 256 because it is a past action. In fact, there already were consultations on it.

Senator **Bingaman**. As you see it, the Canadians could not use this dispute resolution mechanism to challenge the as-billed decision?

Mr. **Reinstein**. Well, in theory they could challenge it, but in practice it is not inconsistent with any provision of the agreement, nor was it something that the United States agreed to change, nor did they have any reason to expect that it would be changed.

We frankly think that there would be no result if they did bring a case. In theory they can challenge a regulation that is on the books, but in practice it would not be successful.

Senator BINGAMAN. Let me ask a question on a slightly different issue. You talked about subsidies, Mr. Ambassador. You said that the whole issue of subsidies in the natural resource area is the subject for later discussion. I guess that gives me a little cause for concern.

I am led to believe by some of the folks involved in energy production that the Canadians subsidize energy production to a greater degree than we do. Now, I understand Secretary Martin has something with him to disprove that, and I would be interested in seeing it.

If it is true that they subsidize to a greater extent than we do, why are we putting off that issue until after this agreement is approved? It is difficult to see where we get a lot of leverage once we approve this agreement.

Ambassador YEUTTER. Well, we did not really have a lot of leverage in the agreement itself, for that matter. You know, all countries subsidize, as you well know. All of us subsidize too much. We subsidize more than the Canadians in some areas; they subsidize more than we do in other areas. The same thing applies with all other countries.

So whether we are talking about energy or anything else, subsidization is a problem, and that is why nations have countervailing duty laws. So that situation is unchanged by the agreement.

We had a lot of discussion about that during the negotiations, Senator Bingaman, even up to the very last. Our Canadian colleagues all indicated that they were fully prepared to discuss subsidy discipline in the future providing we were prepared to discuss subsidy disciplines as well. We indicated that we would, and they indicated that they would. So we will do that in the future.

Until further disciplines are negotiated, however, both of us will have to depend upon our countervailing duty laws for adequate protection, and we think they give adequate protection. So that is the answer.

Senator BINGAMAN. Am I correct, Secretary Martin, that you have some kind of handout with regard to subsidies? Is that something which we are going to get to see today?

Mr. MARTIN. Yes, Senator. In fact, we would like to put up a chart if you wish at this time.

Senator BINGAMAN. I would be anxious to see it.

Mr. MARTIN. Let me say also that energy production and a strong energy economy is important to Canada as it is to us. One of the things that is important is we are both facing a future of increasing oil imports. So it becomes: What is the difference between subsidy and incentive.

To the extent that the Canadians are, indeed, giving some incentives for their oil and gas production, that ultimately, I think, over the longer term will help the United States because we will be in a position to import some of that secure energy as opposed to energy from the Persian Gulf.

I would like to ask Scott Campbell to give a very quick overview of the subsidy situation in the oil and gas industry.

Mr. **Campbell.** I will make it quick.

We like to distinguish between subsidies and incentives for oil and gas exploration. We think incentives are a good thing for oil and gas exploration, and the Free Trade Agreement has specific language in it which says that we can preserve the incentives we have in place on both sides of the border and extend and increase those as Senator Domenici has called for and as President Reagan has called for in certain instances.

We took a look at the tax regime, oil and gas tax regime, the subsidies in Canada, to see if their gas had economic advantages over ours. Basically, when you break it down you have three different types of subsidies or incentives built into their system. You have cash refunds for drilling costs, part of their CEDIP Program, which have been very helpful to the small producers and helped them, I think, to overcome the worst part of the oil price collapse. Those programs are phasing out, however, for gas this year and for oil next year.

The major difference is that the Canadian provinces extend royalty incentives, credits and holidays, and that is a major difference. Unfortunately, since the great majority of their mineral interests are owned by the provincial governments, they can do a lot more with royalties than we can, as most of our royalties are owned by private land owners.

They do do more there, even though some of that is being phased out at this time.

When you look at the tax system itself, I think that the Canadian system is slightly more favorable than what we have. They have repealed their windfall profits tax. In fact, they had two of them. We need to repeal ours.

They allow the expensing of geological and geophysical expenses; we do not.

On the other hand, we do some things they do not do. We have retained the depletion allowance. We have accelerated depreciation. We allow expensing of intangible drilling costs for independents.

So when you compare the two tax systems, I would say for the time being Canada is slightly more favorable. The real difference came for the small producer on the refunds and on the royalty incentives. Both countries probably need to do more, frankly, in the oil and gas incentive area, and we have left that door open.

If you look at what other countries are doing, we are competing for the same kind of capital in a world of capital. They are being much more flexible with their tax and fiscal regimes because they realize in this high cost, low price environment you cannot afford to go out and drill for oil or for gas.

The final sort of bottom line question is whether they impact on our gas producers? Is this advantage that they might have affecting the volume of gas that is coming down and pushing our gas out? We cannot say that it has any major impact. The CEDIP Program is not that much money, and it is a short-run program. We do not think it has a big impact.

We think it is a good thing to look at, though, and we ought to consider what else can be done to enhance energy security through drilling in this country just as Canada has done.

Senator BINGAMAN. You see no subsidies on the Canadian side? This is the incentive chart.

Mr. CAMPBELL. Subsidy is in the eye of the beholder. I like to refer to them as incentives, particularly in this environment where you have low prices and we are a high cost producer.

Senator BINGAMAN. So in your view, there is really no need to discuss subsidies down the road since there are none?

Mr. CAMPBELL. In my view, we ought to be looking hard at our own oil and gas tax regime apart from the Free Trade Agreement. The Free Trade Agreement does not really impact this, but we do need to take a look at it.

Senator BINGAMAN. You think that could be done unilaterally? There is no need for us to sit down with Canada and discuss any of the imbalance that exists between the two industries?

Mr. CAMPBELL. Both countries said they are going to have to look hard at their own oil and gas tax regimes, and they are perhaps going to have to do more.

Ambassador YEUTTER. Let me embellish that if I may, Senator Bingaman.

I would suppose that most people would define everything on that chart as a subsidy. The question is whether they are countervailable subsidies under the trade laws.

The trade laws distinguish between what people call domestic subsidies and export subsidies. By and large, there is little discipline under the trade laws of the GATT and individual countries on domestic subsidies. When nations want to put subsidies into an agreement, those subsidies really have no effect on trade. People do not pay much attention.

It is the subsidies that have an effect that you are worried about of moving product across national boundaries that led to questions about their countervailability. Those are very delicate legal questions, and we can get into those if you would like either now or later. That is really the question, is it a countervailable subsidy?

Senator BINGAMAN. I sort of heard you say, Mr. Ambassador, that these subsidies were going to be the subject of later discussions.

Ambassador YEUTTER. Yes.

Senator BINGAMAN. They were a cause for concern in the administration but they would be dealt with later.

I guess I am hearing from the Department of Energy that these are not subsidies, these are incentives, and to the extent they need attention they could be handled by the Congress, or by the administration unilaterally. There is no need for us to negotiate with Canada about them.

Which is it?

Ambassador YEUTTER. I do not think those comments are at all inconsistent.

What Scott is saying is that some of these issues may not have anything to do with international controversies; that is, these are not export oriented kinds of programs. If there would be any impact on exports, it may be so peripheral and so nominal that it would not be countervailable.

Basically what I was saying is that if we are going to negotiate with Canada or any other country on subsidies, we are obviously going to go after the priority areas. Whether it be energy or anything else, we are going to hit the areas where we think we have the greatest potential to discipline subsidies that are causing us trouble here in the United States.

I am not an energy expert, but some of these things may not cause us any heartburn. If they do not, there is no point in trying to discipline them. If there are items on this list that do cause us heartburn in the sense that they stimulate product coming into the United States in competition with our firms, then we will go after them.

Senator **Bingaman**. No decision has been made as to whether there is a need to renegotiate anything or to proceed to negotiate anything affecting the oil and gas industry?

Ambassador **Yeutter**. No. We have not talked with that specificity on any subject yet.

Senator **Bingaman**. Mr. Chairman, I have a series of other questions I would like to submit for the record, if I could.

The **Chairman**. Yes. We will have questions for all the panel members.

Senator Melcher is not here. Next, Senator Nickles.

Senator **Nickles**. I think Senator Bumpers was before me. I will be quick. It will just take me a couple of minutes.

[The prepared statement of Senator Nickles follows:]

Nickl

STATEMENT OF SENATOR DON NICKLES
COMMITTEE ON ENERGY AND NATURAL RESOURCES

April 19, 1988

I thank the Chairman for holding oversight hearings on the United States-Canada Free Trade Agreement. This bilateral agreement with our most important trading partner appears to be a major milestone in improving international free trade. However, it is our duty to examine this agreement even more closely because of the magnitude of the trade involved, as well as because of the possibility that this agreement may be considered as a model for future free trade agreements.

Information provided by the committee staff indicates that close to 50 percent of the U.S. imports from Canada consist of minerals, fuels, and forestry products. Thus, a significant portion of any increase in imports that results from the implementation of this Free Trade Agreement will affect industries of concern to this committee.

I am particularly concerned about the affect this Free Trade Agreement will have on the domestic natural gas industry. Up to now, I have heard broad assertions that the agreement will not change U.S. regulatory policy--specifically the "as-billed" decision (FERC Opinion No. 256) and similar efforts to achieve a level playing field with Canadian producers. I look forward to hearing from witnesses as to the accuracy of those assertions.

Unfortunately, the fact that the agreement does not affect U.S. regulatory law is a double-edged sword. The regulation of the domestic natural gas industry and the regrettable tax disincentives in the Internal Revenue Code both serve to disadvantage domestic producers in competition with Canadian gas producers. That is why I am pleased to be an original cosponsor of the "Oil and Gas Incentive Equalization Act of 1988, S. 2096, sponsored by the Senator from New Mexico, Senator Domenici.

If this United States-Canada Free Trade Agreement is to serve as precedent for future trade agreements, then it also should serve as an opportunity for the Congress to examine those taxes and regulations that hurt our ability to compete with our trading partners. I hope that this examination, particularly in the case of natural gas, will result in passage of corrective legislation concurrent to the consideration of the Free Trade Agreement.

Senator NICKLES. Ambassador Yeutter, I have just a couple of general comments.

When you put up a billboard like this that says subsidies and incentives and so on, I think you have a very incomplete list. One, you talk about intangible drilling costs. That is expensing out-of-pocket costs.

Depletion only applies to independents. It does not apply to the majors who produce a greater amount.

Accelerated depreciation applies to every industry in the United States.

You did not put up royalties that are paid, and I think our royalties are significantly higher than the Canadian royalties.

You did not put up gross production tax, which is very significant.

You did not put up that we still have windfall profits tax that takes up to 70 percent if the prices go above $19 plus, which the Canadians do not have.

So all in all, I think the Canadians have a significant advantage over United States producers, and I am kind of bothered by the incomplete analysis. A lot of that is our fault. A lot of that is this Congress' fault, a lot of this administration's fault.

I think if we are trying to compare apples and apples, as was mentioned before, that there are some real inequities to United States producers vis-a-vis the Canadian producers which can work to their advantage and possibly to the detriment of United States producers.

Mr. Martin, do you want to comment on that?

Mr. CAMPBELL. Since I am the guilty party who prepared the chart, I will answer that question.

This is just supposed to be illustrative. We provided a more detailed tax analysis to this committee's staff, and I will be happy to send one up to your office as well.

I think you made some good points. There are a lot more factors to look at when you compare the two different systems.

I think our bottom line was, at least for the smaller producer, the Canadian tax regime is more favorable. Whether that should be discouraged or not I would not know. I would think we would want to encourage incentives on both sides of the border.

Senator NICKLES. I do not fault the Canadians for having tax incentives, but, again, I am kind of bothered by this term, Ambassador, that I continue to hear, subsidies. That bothers me.

What about a comparison in royalties? Are United States royalties higher than Canadian royalties?

Mr. CAMPBELL. You are going right to the heart of the problem we have in this country. We have no flexibility with royalties. When you drill a well in this country, as you know, Senator, over 50 percent of the net cash flow that comes out of that production, if it is not a dry hole, goes to the royalty owners and is paid in taxes to the U.S. Federal and State governments.

So when you go to drill a well, you can maybe capture less than 50 percent of the results. You take all of the dry hole costs, of course, and you are doing that now in a province that is very mature and where the up side is very limited because we are drilling infill drilling essentially in this country.

Senator NICKLES. Let me ask an additional question. Again, I said I would try to be brief.

In Oil and Gas Journal, there is a quote that says Canadian gas is not subject to cross-crediting with United States production under Order 500.

Is that correct?

Mr. CAMPBELL. FERC Order 500 is a problem for our producers because the cross-crediting mechanism comes down very heavily on producers.

The Canadians solved their problem because they solved most of their take-or-pay. They do not have the take-or-pay problems that we have, so I do not know the exact answer to that question. I think it is a moot point because they have solved their take-or-pay problems and we have not. That is one of the major obstacles which our producers face.

I looked at the regulatory side, too, to see if there was something on their side of the border that gave them a regulatory advantage. Of course, they deregulated and we have failed to fully deregulate our natural gas. We have failed to decontrol our gas prices, and we have this take-or-pay problem.

If we can clean up our own house, we will be able to compete a lot better. Our biggest problem is, we do not have open access transportation. Our producers can compete with Canadian gas frequently if they can get the gas to the consumer. But too often they cannot get access to a pipeline. As you know, we tried before for open access, and I think we should try again.

Senator NICKLES. So U.S. producers could be faced with this kind of a situation? They are trying to compete particularly in the Northwest and possibly in the future in the northeast with Canadian gas, but they may well have, according to Order 500(c), significant cross-crediting or credits that will have to be applied; therefore, the incremental gas contract that they would be signing with the United States pipeline or purchaser would put them at an economic disadvantage vis-a-vis Canadian gas.

Mr. CAMPBELL. They are disadvantaged because the pipelines contracted for $7 gas and gas is now $1.25 to $2. That has created a tremendous obstacle in the courts, and FERC is trying to deal with it. When they get it out of the way, it will move that gas a lot faster.

Once we get past take-or-pay, it will not be enough. You are going to have to have open access. You are really going to give producers a chance to compete with Canadian gas.

It really has nothing to do with the Free Trade Agreement, but the point is well made that we need to look hard at deregulation again, at open access and price decontrol if our producers are to compete effectively.

Senator NICKLES. One final comment that deals with deregulation. I agree with you in your assessment that we need to deregulate, but the facts are that we have not deregulated. Some of us have been trying to do that, but what if you have a producer that has old gas?

Mr. CAMPBELL. We are trying to make progress through FERC, and that is what FERC Order 500 is all about. We would have liked to see the private parties work that out, but we are moving ahead now and we are hopeful it will be resolved.

Senator NICKLES. Some of us think that Order 500 still has a lot of work that needs to be done and that you have created more chaos than a solution to the problem, and that problem is not going to be addressed and I hope that you do not think it has been addressed by the temporary order that is now issued.

Mr. CAMPBELL. It is not a final order.

Senator NICKLES. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Ford.

Senator FORD. Thank you, Mr. Chairman. I have just two or three quick questions.

Everything in the report and the statements of Mr. Martin and Ambassador Yeutter where they try to say what is going to happen, everything is basically in the near term, 6, 8, 10 years.

What is going to happen in the out years? Has anybody gone beyond the mid-1990's in any of their projections?

Ambassador YEUTTER. You mean in terms of trade patterns, Senator?

Senator FORD. Let me read you two items to indicate where I am coming from.

In Mr. Martin's testimony on page 9, he said, "Indeed, Canada's export of electric power surplus could peak and start declining in the first decade of the next century." That is 12 years.

How secure is this energy supply that you keep talking about?

Then over on page 11, "Canada expects to become a net importer in the 1990's." That is on oil. How secure is that?

We begin to talk about security, but yet it is all short term. If we talk about the 1990's, that is 4 years from now. That would be 1992, so it is all short term.

Now, tell me.

Mr. MARTIN. Well, Senator, you know I am notorious for my bad projections, but let me try to tell you what I think will happen. This committee should take no stock in any projections.

Number one, we do see the potential for greater natural gas imports into the country, perhaps a doubling by the mid-1990's. Most of that, we think, will help displace some imported oil.

In the area of coal, we know that we ship about 16 million tons to Canada right now. It is our largest export market.

Senator FORD. Sixteen million?

Mr. MARTIN. Sixteen million tons.

We have taken a look at particularly the Ontario market and think that there is at least potential to maintain that 16 million tons and maybe even increase it a little bit because it looks like they are moving toward a little bit more use of coal as opposed to nuclear.

Senator MCCLURE. They will get us to pass the acid rain legislation, then they will burn our coal.

Mr. MARTIN. We have taken a look at that, too, Senator.

Senator FORD. Well, there are more Canadians down here lobbying that dang bill than there are Americans.

Mr. MARTIN. In the area of electricity we think that there is the possibility that maybe 1 or 2 percent of our future electrical needs can come from Canada. That is about what it is today, so it will not be a big spurt of energy.

Let me note, for example, that the hydro that we do receive from Canada has saved U.S. electric utilities something like $7 billion since 1973. So I think this is an important point, and hopefully we can preserve that.

The oil issue is a serious one. We are talking a lot about incentives here, because they are just as concerned as we are about the viability of their own oil and gas industry.

The answer is yes, they could be a net importer of oil, particularly in the Eastern Provinces, by the 1990's. So, indeed, I think we both face a challenge in maintaining our oil industry.

So the point is here that we have reached a point where trade is significant. It will continue into the future. It is not a panacea for energy security. Let me say that right now. If we get some gains, if we encourage free trade at the margin, this is important, but we still have one heck of a problem overall in this rising import situation that we have in the 1990s.

Senator FORD. It is the leadership we have had and the bad judgments we have had, Mr. Martin, that has gotten us into a lot of our trouble.

Who speaks for Ontario Power?

Ambassador YEUTTER. I assume the Government of Canada speaks for Ontario Power.

Senator FORD. What about Quebec, then? What about the Quebec Power? Who speaks for them? Are they provincial powers? Yes, they are.

Mr. REINSTEIN. They are publicly owned utilities, and they are owned by the government but they operate as commercial entities the same way certain government-owned public utilities do in this country.

About 25 percent of the generating capacity in the United States is publicly owned, Federal, State and local.

Senator FORD. What recourse do we have if provinces do not carry out the provisions of this agreement? I think that if Ontario and Quebec are provincially owned, then who are they responsible to? If the provinces do not like to carry this out, where are we as it relates to this treaty?

Ambassador YEUTTER. We talked a bit about that earlier, perhaps before you came in, Senator Ford.

Senator FORD. It may have gone by me, too. We will get back to it.

Ambassador YEUTTER. We will be glad to cover it quickly.

First of all, they must follow the agreement. They are obligated to do so. We have made that clear over and over again. It is also made clear in the agreement itself.

In terms of what recourse we have if a province should fail to do so, let me ask Mr. Roh from our General Counsel's Office to give you a specific answer.

Senator FORD. I have dealt with him for several months, and he has not yet smiled.

Mr. Roh, come on.

Ambassador YEUTTER. He smiles a lot at USTR, Senator Ford. It is just here that he is subdued. [Laughter.]

Mr. ROH. Senator, if a province violates the agreement, we can go to dispute settlement as we can if the federal government violates the agreement. If in the end we cannot resolve it by them remedying the violation, then we can retaliate.

Senator FORD. Do we retaliate by termination?

Mr. ROH. The most extreme retaliation is if we decide that the sin is so bad that you cannot make up for it by some more limited retaliatory action, you simply are going to terminate the whole agreement. Both countries have the right to terminate in 6 months' notice for any reason or no reason.

Senator FORD. Can we terminate by parts, or does it have to be at a whole?

Mr. ROH. Senator, you can only terminate the whole agreement, but retaliation in a way can be a kind of termination by part. If you are not going to honor your obligation in this article, then I am not going to honor my obligation to you in another article, and I am going to cause you just as much harm by my retaliation as you have caused me by your violation of the agreement.

Senator FORD. Retaliation is one thing. We have learned that overnight.

If they do cut unilaterally on the energy supply, what happens? What recourse do we have?

Mr. ROH. If they limit energy exports inconsistently with the agreement?

Senator FORD. Yes, unilaterally is what Mr. Martin said a while ago, and you are the legal expert.

What recourse do we have?

Mr. ROH. We can go to dispute settlement, and if we are upheld then Canada either must remedy the action or compensate us, or we can retaliate.

Ambassador YEUTTER. In other words, we have quite a bit of flexibility there, Senator Ford. There are no constraints on how we would retaliate in that kind of situation. We would retaliate in whatever way we felt was appropriate to the United States, and we would probably pick a retaliation that would deliver a strong message.

Senator FORD. Without damaging Canada?

Ambassador YEUTTER. Oh, no. One that would do the maximum in achieving their attention.

Senator FORD. I am rather concerned about all this retaliation. That is the only recourse we have once we sign the agreement. The only way you can get even is to retaliate. We hit them, they hit us, and pretty soon there is blood all over the ground and nothing happens.

Ambassador YEUTTER. That is the only way we have now, too. That is our only recourse now. That is why you put section 301 in our trade laws, and that is why we have been using it.

Senator FORD. I understand you might get another trade law to look at before this thing is signed, too.

Ambassador YEUTTER. We hope so.

Senator FORD. I do, too; the kind that you probably will not like but we will.

Ambassador YEUTTER. Then we are probably both wasting our time.

Senator FORD. I would say maybe not. Things may improve, Ambassador.

You talked about natural gas. How many natural gas pipelines are there in all of Canada?

Mr. CAMPBELL. Does anybody know?

Senator FORD. We are talking about take-or-pay problems. It is a completely difference magnitude in the two countries.

Mr. CAMPBELL. Three. There are three major pipelines that come down from Canada into the United States.

Senator FORD. How many do we have in the United States?

Mr. CAMPBELL. Hundreds. It depends on how you count them. They are all interrelated.

Senator FORD. I wanted to just show you that there was not the same problem in Canada as there is in this country. You have three pipelines up there and hundreds here, and we have at least 30 majors, I guess. So it is 10 times the problem here that they have. Is that about right?

Mr. CAMPBELL. Oh, absolutely.

Senator FORD. I thank you, Mr. Chairman.

The CHAIRMAN. Senator Domenici.

Senator DOMENICI. Thank you very much, Mr. Chairman.

Let me say to our Trade Ambassador, I am not sure that you personally prepared the attachment to the letter dated April 19 with reference to uranium that was promised to us some two or three weeks ago, and I am not critical of the date at this point. I am not sure you are responsible for preparing it. So you and your Energy people will know which one it is, it is dated April 19 to Senator Al Simpson.

[The letter follows:]

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

April 19, 1988

The Honorable Alan K. Simpson
United States Senate
Washington, D.C. 20510

Dear Al:

Thank you for your letter of March 14 regarding the treatment of uranium in the U.S.-Canada Free Trade Agreement (FTA).

As you correctly state, in the FTA provisions applicable to uranium, we have committed not to impose enrichment restrictions on Canadian-origin uranium under Section 161(v) of the Atomic Energy Act and Canada has committed not to discriminate against U.S. uranium processors under their uranium upgrading policy.

With respect to subsidies in general, it is true that we did not get agreement under the FTA to eliminate existing domestic programs which may assist the uranium industry. This applies to both Canadian and U.S. programs. We will be negotiating over the next five to seven years to try to achieve greater discipline in this area. In the meantime, of course, we retain the right to use our CVD law to respond to subsidized imports from Canada. These remedies and others remain in place under the FTA and can be used by the domestic uranium industry to respond to imports which may threaten its health.

With respect to the specific list of measures enclosed with your letter, I would like to comment on the right-hand column, entitled "Information Re: Value of Subsidy." It would be inappropriate for the Administration to suggest in the abstract either whether the measures in question would be countervailable under U.S. law or, if so, what the value of the subsidy might be. Only the Department of Commerce can properly make such determinations in the context of a countervailing duty case.

We have looked very carefully at the list of Canadian practices and have consulted with the Canadian government to see whether the alleged facts are accurate. In general, most of the dollar values appear to be accurate, although their characterization as subsidies may not be. I should point out that both countries have engaged in substantial intervention in energy markets over the years, and especially with respect to uranium. You are well aware that we simply closed our domestic market to imported uranium in 1967 and did not phase out the last vestiges of these restrictions until January 1, 1984. In addition, we required government purchasing of domestic uranium to build the stockpile during the 1960's. I might also mention that the Canadians have noted that many of their programs were instituted to deal with the adverse effects of U.S. trade restrictions on the Canadian uranium industry.

In light of this broad extent of government intervention in the uranium sector, I thought it would be appropriate to reformat the information as in the enclosed table. It shows not only the Canadian programs and other practices affecting uranium but also the comparable U.S. programs and practices. This illustrates very well the history of this industry in both countries.

Al, I think what we have here is an opportunity to put this history of heavy government intervention behind us and allow the situation in the United States and Canada to develop on the basis of market forces. Both industries still have some residual benefits of past government practices, but their effects are small in comparison with the larger impact of market conditions and are continuing to diminish with time. The U.S. industry has opened new mines and reopened some old mines just within the past year. If the industry is concerned about Canadian subsidies, they still have access to U.S. trade remedy laws.

Sincerely,

Clayton Yeutter

CY:rhh

Enclosure

Government Role in the Uranium Industry

Government Role	United States	Canada
Government Ownership	Federal government owns uranium enrichment enterprise.	Federal government owns Eldorado Mining Co. and Saskatchewan government owns Saskatchewan Mining Development Co. (SMDC).
	Federal, State and local governments own major uranium users, e.g., TVA, SMUD, WPPS, and NY Power Authority.	Ontario owns Ontario Hydro, a major uranium user.
Government Purchase of Uranium	Government purchased $1.1 billion worth of uranium for non-defense applications from U.S. (60%) and other producers from 1940s to 1970. Stockpile was created in 1960s, up to 1970, when purchases were no longer needed for national security purposes.	In response to U.S. cutting off uranium imports, Canadian Government created stockpile, purchasing C$101 million worth of uranium from Canadian producers from 1963 to 1970.
Equity Investments	Not applicable.	Federal purchase (1981) of equity in Eldorado via transfer of uranium stockpile from UCAN to Eldorado and settlement of loan, and equity advances by Sask Fund and Crown-Sask to SMDC. Total transaction = C$550 million.
Loans, Loan Guarantees	*Trade Adjustment Assistance Program*: $385 million in loans and loan guarantees was available, but not used by uranium industry.	Federal loans and loan guarantees valued at C$628.2 million at the end of 1986. Saskatchewan loan guarantees valued at C$137 million. Maximum value of assistance is less than C$15 million per year, i.e., less than 2% decrement in interest rate charged.
		Saskatchewan notes held by U.S. banks, proceeds to SMDC. Amount at the end of 1986 = C$583.3 million. There may be some interest rate benefit (maximum 2%), but not more than C$12 million per year.
Import Restrictions, Domestic Purchase Requirements for Utilities	§161(v) of *Atomic Energy Act* may prohibit enrichment of foreign uranium for domestic use. This section was invoked from 1967 until 1984, with no uranium imported into the U.S. for U.S. utilities for 10 years. A gradual phaseout began in 1977 and ended in 1984. Trade restrictions increased revenues to mining industry by at least $250 million by 1977, with continuing effects today though long-term contracts.	Canadian utilities were previously encouraged to sign long-term contracts for Canadian uranium to satisfy "surplus test" on exports, with continuing effects today through these contracts.

Government Role in the Uranium Industry

Government Role	United States	Canada
High domestic prices forced by Government policies	Some U.S. firms (3% of purchases) paid as much as $115+ per pound in 1987, because of long-term take-or-pay contracts made when uranium was thought to be in short supply and enrichment restrictions were still in force.	*Surplus Test* encouraged Canadian utilities to enter into long-term (up to 30 year) contracts. Ontario Hydro has some uranium contracts with prices as high as $70+ per pound, signed during same period as U.S. high-price contracts. Recent contracts with Saskatchewan producers are at lower prices.
Resource Evaluation	*Uranium Resource Evaluation Program* spent approximately $300 million between 1974 and 1984 on: • geologic and geophysical studies, • exploratory drilling and airborne reconnaissance in favorable areas, and • R&D on recovering uranium from low-grade or refractory ores such as phosphates, lignites and shales.	Joint Federal-Provincial *Uranium Exploration Program* was funded at a total cost of C$48 million.
Infrastructure	Government assistance for road construction is common in remote areas where roads serve several purposes.	Government assistance for road construction is common in remote areas where roads serve several purposes.
	The Federal program to promote discovery and production of uranium also included construction or improvement of access roads to uranium mines.	Saskatchewan assistance in road building: C$5.3 million (25% of Key Lake and Beauval-Pinehouse roads).
Mill Tailings	Congress passed *Uranium Mill Tailings Control Act* in 1978. Through 1987, Federal program costs were $317.5 million; the States also have contributed.	*National Mill Tailings R&D Program* costs from 1982 to its completion in March 1987, were C$8.5 million.
Adjustment Assistance	*Trade Adjustment Assistance Program:* $153 million for technical assistance has been available (plus loans and loan guarantees) but not used by uranium industry .	*Mobility Incentive Program* government cost was less than $2 million for relocation assistance to unemployed uranium workers.
	Worker Retraining Assistance Program in trade bill. Present estimated cost = $980 million available for workers in U.S. industries who have lost their jobs as a result of import competition or other reasons.	

Senator **Domenici**. I do not know who is responsible for preparing it, but I certainly would suggest to you that based upon what you have put down on this piece of paper, I would not like you representing me if I were the workers in the uranium industry in the United States, I assure you.

We asked the Canadians to give us theirs, and you gave us what you thought ours were. I would just like to tell you what I think of some of them.

First, you have one down here called Worker Retraining Assistance Program in trade bill, $980 million.

You have one up above that, Trade Adjustment Assistance Program. You were at least credible there. You said it was not used by the uranium industry.

You know what this reminds me of, to put trade adjustment money in that is not used by the industry, $980 million that has not become law yet? It sort of reminds me of you all telling a veteran that you are giving him a subsidy when you provide for his burial, for his grave. It sounds very, very similar to me.

First of all, it never dawned on me that you would list for use by the Canadians now that there is some kind of parity of subsidy such things as an unpassed $980 million trade adjustment program, $153 million program that has never been used by them—and do not answer yet because I want to go on and talk about the first part of it.

Whoever prepared it, were you aware of the fact that the United States Government owned the uranium industry lock, stock and barrel, controlled it until a point in time? Were you aware of that? I assume you were.

It was an American Government-controlled industry; right? The Atomic Energy Commission bought and sold and totally controlled it, and yet you list as a subsidy to the uranium industry of the United States, and Senator McClure will be interested in this, $317 million that we spent to clean up the dead mill tailing ponds that Congress in its legislation said was a direct cost to the Federal Government when it controlled the industry and there was no charge imposed to make the cleanup. Now you call it a subsidy of $317 million or some kind of expenditure.

Frankly, I really believe, and I say this with greatest respect to all of you, that you have gone out of your way in all respects with reference to uranium to make sure that we have no uranium industry. You must have gotten marching orders from someone and from the very beginning you decided that is what you wanted. Now in your incentive list you will even go to these kind of ends to prove that there is some kind of incentive for the Government's role in the uranium industry.

Now, maybe you did not mean incentive. Maybe you just meant the Government's role. If you meant the Government's role, what relationship does that have if it is not an incentive?

Now, I have said enough. There are a whole bunch of them in here that are the Government's role. Of what relevancy is this if it is not to show some parity of subsidy between the two countries? Could somebody answer that?

Ambassador **Yeutter**. Let me make a preliminary comment, and then I will ask Bill or Scott to respond to this. This chart was prepared by the Department of Energy, and so I will ask them to make whatever comments they wish about it.

I would comment only on the latter part about trade adjustment assistance, because as I signed that letter this morning I noticed the inclusion of amounts that go beyond the uranium industry, and I asked that that be corrected before the letter was sent on to Senator Simpson. The correction is certainly not to my satisfaction. As you know, I came over to meet with you all, and so the enclosure went after I had signed the original letter.

Senator DOMENICI. Would you think the $153 million ought to come off, too, since the uranium industry would not use it?

Ambassador YEUTTER. I agree. Well, I certainly agree that the only trade adjustment assistance that ought to be encompassed is the amount that is applicable, whatever that may be, to the uranium industry. I am sorry that that wording was not appropriately changed.

Other than that, I would like to ask Bill or whomever to make any explanatory comments you might like to make.

It is clear that there was no intent to make at all relating to subsidies. It was an attempt to articulate the role of the government in the industries.

Senator DOMENICI. I do not think that I have said anything here that is not listed, and I do not want to take the committee's time with a very long explanation.

Is it fair to say that this does not purport to be the subsidies that the United States has either given to the industry or permitted the industry to have over the years since the birth of atomic energy? Is that a fair statement?

Mr. MARTIN. That is fair, Senator.

Senator DOMENICI. All right. Then its relevancy has to do with what the Government's role in the uranium industry and the uranium business from the inception through a not-yet-passed but maybe-to-be-passed trade adjustment law. Is that a fair statement?

Mr. MARTIN. That is precisely what the title says.

Senator DOMENICI. But it was sent to the distinguished minority whip, and I was present when he asked about it. My thought with respect to subsidies in general, is whether that is what he asked in my presence that you produce? Is that what we asked you for? Is this not in response to the request that we get the subsidies down on a piece of paper and the incentives of the two countries?

Ambassador YEUTTER. Yes. But I think, Senator Domenici, the staff has tried to go beyond that and articulate a broader role. I am told that they worked out this chart or the format of the chart with one of Senator Simpson's staff people. So this apparently was a common understanding as to what they were attempting to include that went beyond subsidies.

I am not privy to all of those staff discussions, Senator Domenici.

Senator DOMENICI. So I accept that as an explanation, and let me move on unless you want to explain further.

Mr. MARTIN. No, but I think it is an interesting chart. I think it is useful as we think about do we have a level playing field in whatever area we are looking at, what has been the Government role. I think it is a very valid framework to look at, and we can call a subsidy a subsidy or whatever.

But I think we were trying to be responsive to say that we did not ignore the fact that we are not scot-free in this country as far as never having anything to do with the uranium industry. So that was really the intent of this.

Senator, we would be glad to go over it line by line with you and correct it as appropriate and make it part of the final record, something that would reflect what you think is an honest appraisal of the Government role in the industry.

Senator DOMENICI. I think that would be helpful.

Mr. MARTIN. Then we can get a fair statement. We would be glad to do that.

Senator DOMENICI. Let me ask a couple of questions.

It is my understanding that the administration is appropriately proud of and pleased with the energy security blanket that this Canadian Free Trade Agreement might provide for the United States in the event of another serious shortfall.

Let me say right now with respect to that, that I concur. When you have two giant countries like this in an energy shortfall, it is a very good understanding to say they will sell at the same price on both sides of the border, and they will prorate their production in the event of a crisis. If we were getting 40 percent, we will keep getting it. So please understand that I understand that.

Now, having said that, let me ask you this. From the standpoint of the Secretary of the Treasury and the President's economic advisor, have you ever heard them say that there is any difference in a trade imbalance if it is with Canada or with some other country? If we are $125 billion in the red, if we are not now coming up with some microdifference within the macroeffect of having a big trade deficit, are we?

Ambassador YEUTTER. No. As a matter of fact, as you well know, Senator Domenici, we believe very strongly that we have to look at the trade deficit on a global basis, not on a bilateral basis.

Senator DOMENICI. Now, let me tell you what I think, and I do not know who is to blame, but I believe if we do not implement in advance of this agreement some incentives for American small producers and make sure that the regulatory schemes that we had in effect prior to the execution of this agreement with reference to natural gas, I will give you my version of what we are going to do.

We are going to become more dependent, not less, on foreign oil, and it may very well be that that dependence will be slightly more toward Canada than it is today. But the dependence will grow, it will not diminish, because I think it is unequivocal that we are going to produce less oil rather than more when this agreement is finished, and the Canadians are going to export more natural gas, substantially more, to the United States, not less, as a result of this agreement.

As a matter of fact, I would suggest that your tax expert take all those incentives that you have up there—and you quite properly said if we are fools enough not to have more incentives we should not be blaming them because they are smart enough to have them. I am paraphrasing.

Let me suggest to you that it is not very easy to get incentives for oil and gas in the Halls of Congress. You ought to look at the last tax code before you put those incentives up and figure in the alternative minimum tax.

You will find that the independent oil producers are the ones really suffering from the alternative minimum tax because when they are through with all those incentives that we permit them, they also have to apply the alternative minimum tax, and it dramatically diminishes the incentive because the incentive is to the taxpayer on his tax return, and he only has to do that a couple of years to find that the writeoff did not show up when he figured the alternate minimum tax.

I conclude that your very gentle statement in your preliminary report, and I am paraphrasing it, suggests that the small producers operating within the limits of Canadian incentive programs will experience lower overall tax and royalty obligations than comparable producers operating in the United States. That is your own conclusion.

I will say to you if you add to it the alternate minimum tax, that statement will grow, and it will not be that this might be the case. It will be that that is the case for sure.

I am only suggesting that you ought to take advantage of the Canadian Free Trade Agreement to ask the Congress of the United States to play some catchup on incentives.

If we have not passed a windfall repeal, you ought to ask for it as part of this agreement. To follow my junior colleague's questions, it will not come 2 years from now. We are going to have less and less production in Louisiana, New Mexico and Texas, not more.

Having said that, let me ask you this question. Is there anything that prohibits the Congress of the United States or you from passing parallel with and simultaneous with this treaty enabling legislation that would cause some of the inequities on the incentive side to come back into balance?

Ambassador YEUTTER. We would have to evaluate that, Senator Domenici, obviously in terms of the specifics.

Senator DOMENICI. I understand, Mr. Ambassador. Your question is whether you want to do it. But my question is is there anything that precludes us from doing that?

Ambassador YEUTTER. First of all, let me preface my answer by saying I agree with a great deal of what you say, maybe all of what you say. We do have a challenge in this area, and as between using incentives to solve this "problem" and using import restrictions, obviously I would much rather see us use incentives.

What we have to be careful about is whether any of those incentives would be incompatible with the Free Trade Arrangement. If they are, obviously we cannot support them.

If we can provide incentives, however, that would be compatible with the Free Trade Arrangement, then I would see no difficulty at all conceptually in doing them. Now, whether the administration would be prepared to support the specific incentives you have in mind, Senator Domenici, obviously we cannot answer that question in a vacuum.

Senator DOMENICI. Well, then let me be very specific to see if we are developing some kind of a framework that this committee might understand.

You are aware of the FERC regulation on as-billed which Senator Bingaman asked you about. Do you recall that during your negotiations that this Senator communicated regularly with you about that FERC regulation? You were very good about it. You reported back, saying we are preserving it. You did not say this, but I say it. It is only fair. They were trying to cheat and get the price down so that they could get into the commission in California with cheaper gas. You said we preserved it.

Now, hypothetically, since they say it is subject to consultation and negotiation later but we say it is not, could we not include in our enabling legislation a statement that that FERC regulation is operative rather than leave it up to later discussions?

If we cannot, why can we not?

Ambassador YEUTTER. I am not sure whether we have an immediate answer for you, Senator Domenici. The question is can you incorporate these kinds of things in the implementing legislation.

Senator DOMENICI. Right.

Ambassador YEUTTER. Or, I guess, the alternative obviously would be to do it in separate legislation simultaneous therewith.

Senator MCCLURE. One of the difficulties, Mr. Ambassador, is that our approval or disapproval is not divisible, and it is not amendable.

Ambassador YEUTTER. Yes.

Senator MCCLURE. At the same time, anything that is put into the implementing legislation when it is set up we can consider. I think that is what Senator is addressing.

Mr. REINSTEIN. Senator, let me clarify the question. This has to do with the Canadian introduction to the energy chapter, I think you are referring to, on page 142. I see that you are holding the same bible that we have here.

It makes a reference to the as-billed decision, but it says "such as decision like the as-billed decision". It uses that as an example of a decision that the Canadian government viewed as discriminatory. It says, "In the future, decisions such as this could be challenged" or at least request consultations on them. So it is really looking ahead to the future and merely picking this as a past example of the kind of thing that they might object to.

I do not think it indicates in any way that they would go after the Opinion 256.

Senator DOMENICI. It just seems to me you are not living in an oil patch, in a natural gas patch. We are. Those of us who are on these systems that are feeding California and that is the only way we can ship natural gas, we are very concerned. This as-billed provision is the difference between selling Four Corners natural gas to California and having the Canadians take over the market. So it is not just one of these maybe questions. It is kind of life or death.

Why we can we not assure that in some way?

Mr. REINSTEIN. Senator, we did not grandfather the as-billed decision in the agreement. To write in the legislation that it was grandfathered as part of the implementation would be doing beyond what is in the agreement.

We are quite confident that it could not be challenged under the agreement. We are quite confident, and I can go through an elaboration based on the negotiating history if you would like, but we do not think it is necessary at all to grandfather.

Senator DOMENICI. I just do not have as much confidence, and this is not directed at you. I just do not have that much confidence that we will make the right deal 18 months from now.

My last question has to do with the 10-year phase-in of a graduated import limitation on uranium as contained in the major bill reported out of this committee and voted in on the floor.

You do not support it. I understand that. You do not think we need it for national defense or other purposes, but my question is if Congress were to pass it and if the President were to sign it, the latter being a very big if I understand, would that be in violation of this agreement?

Ambassador YEUTTER. I will have my experts ratify this if they would, but my understanding, Senator Domenici, is that it would be in this violation of this agreement.

Senator DOMENICI. Why?

Mr. REINSTEIN. It would violate Chapter 5, the provision on national treatment, which essentially parallels the concept in the GATT that you do not discriminate against foreign goods in your internal domestic regulation and taxation schemes. That is, the things which are applied at the border, tariffs, once you get past them and you are in the country, everybody in the market gets treated the same, whether it is domestic or foreign origin goods.

Senator DOMENICI. You understand that section of the law that is being amended, 161(v), states within it that since it is in the national security interest of the country GATT does not apply.

Now, is it GATT that precludes it from being operative, or is it this agreement that precludes it from being operative?

Mr. REINSTEIN. The GATT applies, Senator. Article XXI of the GATT provides an exception where a country declares that there is a national security concern.

Now, when we look at the Canadian agreement, we have elaborated with some specificity what kinds of concerns would be considered a national security concern. In particular with regard to fissionable materials, it is a threat to our ability to have adequate supplies for military requirements.

We have done an assessment of this, and I turn to the Department of Energy to elaborate on it, that our uranium supplies for military needs will be quite adequate without trade restrictions. If you would like, we can elaborate on it.

Senator DOMENICI. No, I do not want another explanation. I have heard it for 30 years, and I do not agree with it. I do not intend to have a debate on it. I heard Secretary Martin say that. I do not think so.

I think they plan to buy some in 1992, so I would guess they were buying it for some reason other than because they needed it. Other than that, that is all I would have to say.

Thank you very much, Mr. Chairman.

Senator MELCHER. Mr. Ambassador, I think you probably know that the longest common border of any of the states is between Montana and Alberta and Saskatchewan and a portion of British Columbia.

You know, they are not only our trading partners, they are our neighbors. Despite any little argument we have with them, we always get along with them. We invite them down to try to adjust their differential in their money between ours and theirs and stay overnight and spend some dough in Montana. You would be surprised. They do, actually. We very much welcome them.

I do not know whether you know it or not. Were you out to the Olympics at Calgary?

Ambassador YEUTTER. No, I did not have a chance, but I was just there a couple of days ago.

Senator MELCHER. You watched them on television. I was not up there, either, but you watched them on television and you saw those warm chanook winds?

Ambassador YEUTTER. Yes.

Senator MELCHER. We tried to do the neighborly thing. You know, they come out of the southwest. We tried to do the neighborly thing and trap them all in Montana before they got up there so the Olympics would go off better, and to the extent we failed we all lost in how much snow there was.

Ambassador YEUTTER. You ruined those acrobatic skiers for a day or so.

Senator MELCHER. Well, we are really friends with them, and so nothing I have to say is anything but pure, unadulterated friendship with our neighbors.

I am sure you will recall when Canada, on their blue tongue and anablysmosis tests on cattle and some different things, made it hard to get cattle into Canada. Without that doubletesting it's almost impossible.

Have they still got that?

Ambassador YEUTTER. I cannot tell you. You are too far away from my USDA experience, Senator.

Senator MELCHER. It ought to be in here, should it not?

Ambassador YEUTTER. Well, there are provisions in here, as a matter of fact, on those kinds of issues, but I cannot tell you specifically whether that is covered.

Senator MELCHER. Have they still got a sugar quota from the United States? Have they got a sugar quota? Has Canada got a sugar quota from the United States?

Ambassador YEUTTER. Yes, they do.

Senator MELCHER. That is maintained?

Ambassador YEUTTER. It is because that is an issue that is unchanged in any way by this agreement.

Senator MELCHER. Well, you think between neighbors we would clear up some of these old hurts. It does not make much sense for a net importer, as Canada is, importing the sugar from Cuba and then sending it down under a quota and getting about 12 cents a pound. That is a subsidy out of us.

Ambassador YEUTTER. I agree with you, Senator Melcher, but Canada has some GATT rights in that case which we cannot abrogate in this agreement.

Senator MELCHER. I think we should get law to change all that.

Now, timber, it took us about four or five years or longer. How long, 10 years? It took some time to get an agreement out of them where they are only going to take about 28 percent or 20-some percent of our soft wood market with our subsidized timber.

How do you treat that in this?

Ambassador YEUTTER. Well, the agreement did not relate to the percentage of our market they could take. This was not a market-sharing agreement.

What we negotiated very successfully was the elimination of their stumpage discrimination. I believe our timber industry is completely satisfied with that result, or at least I have heard no complaints whatsoever since the agreement was negotiated, and that agreement is fully preserved in the FTA.

Senator MELCHER. Good.

Now, while I was here I listened to this dialog on FERC's 256, and I have reviewed some of the questions and answers that were given while I was out of here.

How would FERC 256 apply on Northern Border pipeline? Is northern border about half full now, about half capacity or a third or what?

Mr. CAMPBELL. This is a prebuild pipeline, as you may know, Senator, part of the commitment we made to Canada when they built the ANGTS pipeline. So it is exempted from Order 256.

Senator MELCHER. It is about half full or less?

Mr. CAMPBELL. Well, they went open access on July 1, so the capacity is up. We are not sure what it is. It was about half, and then it went open access and it is getting larger now.

Senator MELCHER. Is that a 48-inch line or 42?

Mr. CAMPBELL. I do not know, but we have about 1.3 trillion cubic feet that can come across in total capacity. We are not there yet, but that limits them to about 5 percent of the market, maybe a little more nationally.

Senator MELCHER. To whatever extent they could just dump some more gas in there, then they are exempt from 256?

Mr. CAMPBELL. On that pipeline they would be exempt.

Senator MELCHER. Is that the way you interpret it?

Mr. CAMPBELL. Of course, what they are doing is they are going directly in to customers in many cases, but they are exempted from 256.

Senator MELCHER. Well, if 256 is supposed to be beneficial to the United States, then it would appear that there could be an awful lot more gas coming from Alberta that 256 would not apply to.

Mr. CAMPBELL. Order 256 applies to system sales or long-term contract gas. As you can see from our chart, at one time the dominant amount of gas sold was on system sales, 90 percent as late as 1984; but today, about 30 percent is on system sales and 70 percent is on the spot market.

Order 256 applies because in many cases, in the case of contract sales of consumers at the table, you are selling to a pipeline, and you can then pass through these fixed costs, in whatever manner they would want, through to the consumers not at the table.

Now, in direct sales you are dealing directly with consumers so you really do not need 256. So in many cases, you do not need the protection of 256, but you sure do on the contract sales. That is the jurisdictional rationale.

Senator MELCHER. Are we talking about contract sales? Why talk about other sales?

Mr. CAMPBELL. Well, because this 70 percent of the market is now in spot sales.

Senator MELCHER. In a glut time, 70 percent is spot?

Mr. CAMPBELL. Right now it is, yes.

Senator MELCHER. You know, it may not stay always the same.

Mr. CAMPBELL. I think the change comes from open access to a large degree and the opening up of pipelines. Before, you did not have much open access. I think that is one of the fundamental changes that will keep it that way.

Now, you may get——

Senator MELCHER. What good does it do to us for Montana producers to have access to that if Alberta decides to sell it cheaper? What good does it do to have access to it?

Mr. CAMPBELL. United States producers can compete with Canadian gas if they can get their gas to the market. That is why we need open access on our side of the border. We do not have enough of it. That is the main problem.

Senator MELCHER. I guess you and I are thinking differently. I am thinking of a situation where they chose to subsidize their gas sales. Are you thinking that way?

Mr. CAMPBELL. I do not follow the question. I am sorry.

Mr. REINSTEIN. Senator, Opinion 256 applies to the way certain costs are allocated among the two components of the gas charge. I do not think there is an implication that gas costs will not be recovered, but the question is how they are recovered. Are they recovered in the commodity portion of the charge or in the demand portion of the charge?

I do not understand how it would be considered necessarily a subsidy to say which of those two baskets a particular set of charges went into.

In particular, for example, gathering system costs could quite arguably and reasonably be put into the demand charge as they are in Canada. There are some people who happen to think the Canadian system of allocating gathering system charges to the demand charge is a more logical and better system.

What Opinion 256 does is it simply says there is going to be one set of rules for all of the pipeline sales under FERC jurisdiction in terms of where certain kinds of costs are allocated. I do not see how you would say the Canadian system is a subsidy. It is just a different way of allocating those charges.

Senator MELCHER. I am saying what if they chose to subsidize?

Mr. REINSTEIN. That is an entirely different question. It is a hypothetical question.

Senator MELCHER. All right, let us go on it. What does this agreement say about that?

Mr. REINSTEIN. With regard to subsidies, they are subject to our countervailing duty laws. If they chose to institute a new subsidy and it resulted in injury to our producers, they would have the ability to bring a countervailing duty case, as they can today without the agreement. It does not change that.

Senator MELCHER. Do you believe that, given the circumstances where the pipeline capacity is available and they chose to subsidize it, our protection against that is countervailing duty laws which are not going to be changed?

Ambassador YEUTTER. That is correct.

Senator MELCHER. How would the judicial review be?

Ambassador YEUTTER. We do not believe that will substantively change the outcome at all.

Senator MELCHER. How is it changed?

Ambassador YEUTTER. It is only changed in that at the end of the procedure once a decision is made, that is, in our case the way the countervailing duty process works is that we have the U.S. International Trade Commission and the Commerce Department make all the necessary calculations and then ultimately at the end of that extensive process there is a decision made by the Commerce Department.

Today that decision can be challenged in the Federal Courts here in the United States. Under this agreement, the decision by the Commerce Department would be challenged not in our Federal Courts but in this binational tribunal.

However the binational tribunal must apply precisely the same standards of review as our Federal Courts do, so we do not believe it will change the outcome at all because they have to operate under exactly the same review standards.

Senator MELCHER. I do not know. The binational tribunal is not very encouraging to me because what about the deal we had with them on blue tongue and anablysmosis on cattle? What about the sugar quota?

The situation is that we do not seem to come out quite right when it is a bilateral decisionmaking process. We just do not seem to win on those because the Canadian attitude, and rightfully so, is that they are about 20 percent of our population. They import so much stuff from us that if they have to have a few gimmicks to balance that off and to be a big customer of the United States, those few gimmicks are all right.

So it always comes down on the side of Canada on that, and that is exactly why we had a bad deal with them on some diseases, situations where we were a little bit lax and understanding. When they brought brusolosis cattle or shipped us brusolosis cattle, we were very understanding about it. We worked it out.

But on the other side, when they hauled us up on anablysmosis and blue tongue, they were not afraid to do that.

What happened when they, contrary to our law, imported beef from other countries and transshipped it into the United States? What happened? Do you recall?

Ambassador YEUTTER. I do not remember the outcome any more, Senator Melcher.

Senator MELCHER. That is right. Hardly anybody can remember the outcome because nothing happened.

I am not very happy with the tribunal decisionmaking process to replace the Federal judiciary here because I believe it is a flaw in the agreement.

Ambassador YEUTTER. I hope not, Senator Melcher, if I may just comment on it for a second.

The panelists will be quality individuals from both countries, and by that I mean this will be a highly select group from whom selections will be made because it is kind of like an arbitration process which, of course, has had a lot of use in this country. Two selections will be made by the Canadian side, two from our side, and then the fifth one will be selected in a variety of potential ways, but that is to give the balance.

We believe that the people will be of the quality and experience and background that they will give sound decisions and, clearly, Canada will have no more than two out of five on that panel.

So we believe it will work satisfactorily.

Senator MELCHER. I do not know. On some of these points, it would seem to me, we would be better off protecting ourselves from something we know might happen because it has happened in the past.

Ambassador YEUTTER. We have had some of the same problems. I do not mean to prolong it, Senator Melcher, but we have had some of the same problems in Canada's application of their countervailing duty laws and antidumping laws against us. One of them recently has been on corn, as you may know.

There is not a whole lot of corn in Montana, but some, and our corn producers are pretty unhappy the way that countervailing duty case has worked in Canada. They are saying that they wish we now had in place this kind of a binational panel because we believe we would have a chance at a better outcome in Canada on that case, which has certainly hurt our corn producers.

Senator MELCHER. Thank you, Mr. Ambassador.

Senator Murkowski.

Senator MURKOWSKI. Thank you very much, Mr. Chairman.

Mr. Ambassador, I think you have heard it said that this Canadian Free Trade Agreement is a boon to the United States consumer but somewhat detrimental to United States resource producers, and I think the comments by many of our colleagues today has highlighted that there are certain segments of our basic resource industry that are probably not going to do very well. The uranium industry has already been cited.

It would seem to me that in your discussions the substantial benefits of the railroad system that Canada enjoys, the Canadian national system, which is a government-owned railroad which has the capability of moving resources to either coast, particularly the west coast, whether it be coal or minerals or so forth, for export to the Pacific Rim countries, puts our resource producers at a substantial disadvantage because we do not share that same aspect of what really amounts to a subsidy benefit.

I am just wondering how in your deliberations you resolve this obvious reality and are prepared to live with it as a situation in which we really cannot be competitive in many areas?

Ambassador YEUTTER. Well, we did challenge the transportation system in some respects and, in fact, succeeded in making some changes in the negotiations.

I will ask Mr. Reinstein if he would like to add a supplementary comment in just a second on that, but I would like to go back and comment on the preface of your question which related to the probable future of our natural resource-based industries in light of this kind of additional competition.

It is certainly true, Senator Murkowski, that there will be over time, at least, more Canadian competition, but I really believe that the concerns of our producer groups have been overblown in the sense that they are already in that kind of a competitive world with our Canadian friends.

Basically, our energy trade between the United States and Canada is now open. We essentially have no impediments to Canadian energy flowing into the United States right no. So if our companies are surviving at the moment, Senator Murkowski, they ought to be able to survive in the future.

What we are hearing from our uranium folks is not so much concern about their present situation, although obviously they are not doing splendidly, but the inability under the FTA to add import restrictions in the future. In other words, they would like for the U.S. Government to have the privilege of applying import constraints in the future, and we just feel that that is inconsistent with the spirit of the FTA.

Let me ask Mr. Reinstein if he would like to comment on the transportation issue.

Mr. **Reinstein**. We did not get involved in the transportation issue in the energy discussions.

Senator **Murkowski**. In coal there was no consideration given to the ability of U.S. coal producers to export in the Pacific Rim on the obvious transportation inequity? I find that extraordinary.

Mr. **Reinstein**. Export to the Pacific Rim? You mean third country trade?

Senator **Murkowski**. I am talking about coal export from the United States to the Pacific Rim, steam coal as opposed to Canada's export of steam coal. We both are competitive.

In Wyoming you have Ottawa River coal that is attempting to find its way into the markets of the Pacific Rim countries. You have Burlington Northern that is attempting to try and make competitive rate structures, and the Canadian system that can set any rate it wants.

Ambassador **Yeutter**. As I indicated earlier, Senator Murkowski, we did not try to deal with subsidy issues by and large in this agreement.

Senator **Murkowski**. That was made clear earlier in your statement. You said that the subsidy issue was going to come later. The reality which has been brought out time and time again, if you are going to take a stand and have your position prevailing and you have some leverage, your leverage is as you formulate the agreement to address the equity of certain subsidies so that we are still going to be allowed to be competitive and have some competitive opportunities.

It seems to me that this one is left hanging out to either dry or get wetter, depending on the whims of the ability to negotiate something that Canada certainly does not have to buy.

How are you going to go in and negotiate after the fact the issue of Canadian subsidies and their fairness vis-a-vis our own ability to compete in an export market with Canada if Canada chooses to continue their subsidies? What leverage are you going to have, Mr. Ambassador?

Ambassador YEUTTER. The only leverage we have in that kind of situation is to a horse trade with them involving some of our own subsidy practices. That would have been the same thing in the FTA negotiations.

There is nothing in the GATT rules that would help us there. The GATT rules really would not preclude the Canadians from using the kinds of subsidies that they now have in transportation, or at least I doubt they would.

So we have two choices. We can either apply our own subsidies to neutralize the Canadian ones, assuming both subsidies would be permitted under the GATT rules, or, secondly, we can horse trade with them and try to get them to reduce or eliminate their subsidies. Obviously, we are going to have to give the Canadians something if they are going to give up something.

Senator MURKOWSKI. Let me put the question another way.

What obligation do you have in your office to protect the interests of United States resource producers who are trying to export into a market and Canada is also trying to export into that market but they have the benefit of subsidies?

What obligation do you have to protect the interests of domestic resource producers?

Ambassador YEUTTER. I think just as government officials, we have an obligation to try to help our American firms wherever we can no matter what the situation is. Whether we have any kind of leverage is another matter, because as long as those Canadian subsidies are legal, we have no leverage.

Senator MURKOWSKI. But you had, theoretically, the leverage of the attitude of the Canadian government to pursue the Canadian free trade talks. The objective was to conclude an agreement that was in the mutual interests of both countries.

Now what you have done here is you have developed an agreement which removes tariffs, but it does nothing to reduce the subsidies that many of the Canadian provincial governments have and basically direct toward favored industries. That is just a hard, cold fact.

Ambassador YEUTTER. Sure. The reason for that was we were not prepared to give them what they wanted in the horse trade. We debated subsidies with them at great lengths, Senator Murkowski, but what they wanted in the horse trade was an exemption from our countervailing duty laws, and we said no. They said, well, if you do not give us an exemption from the countervailing duty laws, we are not going to discipline our subsidies. That was the oversimplified essence of the argument.

So we concluded that we would prefer to leave those subsidies in place and keep the protection of our countervailing duty laws rather than to give up the latter.

Senator MURKOWSKI. It seems to me that by overlooking or not addressing the subsidy issues, you could consider, theoretically at least, that you have increased the longevity of the subsidies because we did not highlight their importance, and they are going to be that much harder to get rid of.

Ambassador YEUTTER. I do not agree with that, because we do have an agreement with the Canadian government that we will pursue the subsidy issue in the aftermath of the approval of the FTA, and they are also working with us in the Uruguay Round.

So, as I said earlier today, we will go after those subsidies in both courts. But I think we have just as much leverage in the future as we had at the time of the negotiation of the FTA because they were not about to give us any freebies in the FTA. It would be nice if they would have, but our Canadian negotiating colleagues are too intelligent to do that.

Senator MURKOWSKI. Do you think that we make a mockery to some extent of some of our industries when we say the mining industry in the United States is free to export into Canada when we know very well that the subsidies available to the Canadian mining industry into the markets of the United States are going to eliminate any opportunity for us to export outside the United States into Canada? These are just hard realities.

Ambassador YEUTTER. As I said, insofar as penetration of the United States market is concerned we obviously have the protection of the countervailing duty laws.

Insofar as Pacific Rim sales opportunities are concerned, to the degree Canadian subsidies give them an advantage over us in the Pacific Rim we obviously have to try to negotiate away those subsidies.

As I said, we can either try to do that bilaterally, or we can try to do it in the Uruguay Round, or both. But those subsidies are not GATT illegal, so we have to negotiate them away. It takes two to tango.

Senator MURKOWSKI. That is true, but why is Canada going to be so interested and so motivated to negotiate their subsidies away after this agreement is signed?

Ambassador YEUTTER. They may be just as motivated as they were before the agreement is signed.

Senator MURKOWSKI. I do not necessarily agree with that. It would seem to me that the agreement itself would be the leverage to try to address some of the more crass subsidies that we are faced with and to come down with an agreement that is extremely beneficial for the consumer, but you have the resource producers in this country very concerned.

It looks to me like we have half the barn door taken care of, and the other half is going to be addressed at a later date without very much leverage.

Ambassador YEUTTER. We have a lot of subsidies, too, by the way, and so Canada is not pleased with the subsidy programs that we have in place as well.

Senator MURKOWSKI. When do you anticipate going after the subsidies, assuming we get the Free Trade Agreement signed?

Ambassador YEUTTER. Promptly. In other words, probably next year.

Senator MURKOWSKI. I am also concerned about the momentum that Canada is generating as the Free Trade Agreement currently sets in its posture. They seem to be tightening up certain things, and I believe that there was a statement according to the Canadian Minister of Trade, Pat Carney, commenting on the lack of understanding allegedly among U.S. Senators and Congressman.

According to Pat Carney, the opposition is less than expected. Canada will proceed with its "duty remission scheme" to subsidize textiles and clothing and will impose import quotas for dairy products. Almost simultaneously, the federal and Saskatchewan governments announced the merger of two of the largest government energy corporations, Eldorado Nuclear Limited and Saskatchewan Mining and Development Corporation. Announcing the merger, Canada indicated that the resulting entity will be privatized but that the total foreign ownership will be limited to no more than 20 percent, no more than 5 percent per individual foreign company.

Now, is this not contrary to the spirit of the FTA?

Ambassador YEUTTER. I will ask Mr. Reinstein to comment on that one, if I may. I will comment on the others, which would be textiles and dairy products.

Certainly those two do violate the spirit of the FTA, Senator Murkowski, and I believe it would have been prudent of our Canadian friends not to have put either of those in place. They had the privilege of doing so, but it seems to me that both sides should attempt to honor the standstill commitment that we made at the time we concluded the negotiations, the essence of which was that we would try to avoid taking actions violative of the spirit of the agreement between that time and its going into effect next January.

The one on textiles, after considerable opposition from all of us, has been changed dramatically. Though specific mention was made of that possibility during the negotiations, the program that was announced was of a magnitude far in excess of anything that we had contemplated. We objected vehemently to that, and the Canadians then scaled it way, way back to the point where we believe it looks all right at the moment, not ideal but I think generally satisfactory.

The one on ice cream has little effect on trade, so it is more symbolic than real and permitted under the GATT and under the FTA. Again, we believe that is very unfortunate symbolism.

With respect to the other one, Mr. Reinstein?

Mr. REINSTEIN. The privatization of the combined Eldorado and Saskatchewan Mining and Development Company would not have to be offered for foreign investors under the provisions of the agreement. Article 1602, paragraphs 5 and 6, provide that the Canadians, if they privatize an existing crown corporation, do not have to offer that for foreign ownership.

Senator MURKOWSKI. Is it because it is private?

Mr. REINSTEIN. Excuse me?

Senator MURKOWSKI. What is the differentiating point as to why? Because it was a private?

Mr. REINSTEIN. I did not negotiate the investment portion of the agreement. This is in the investment chapter. It was negotiated by another group. I am just simply noting that there is a provision in that chapter, Article 1602, that allows for restriction on foreign ownership in the privatization of crown corporations.

Senator MURKOWSKI. What did the Free Trade Agreement say about no restrictions of ownership?

Ambassador YEUTTER. I am not sure whether I fully understand your question, Senator Murkowski?

Senator **Murkowski**. Well, is this a contradiction? In free trade agreements, everything is free. Tariffs are down, ownership across the border, and fine.

Now we find this announcement of the two largest energy corporations merging, and they say no foreign ownership over 20 percent, no more than 5 percent per individual foreign company. I think we have both agreed it is contrary to the spirit of the FTA, but there it is.

Ambassador **Yeutter**. I think it is clearly contrary to the spirit of the FTA, which is one of opening markets and opening investments, Senator Murkowski.

Senator **Murkowski**. And opening ownership.

Ambassador **Yeutter**. There is no doubt about that. We do not have any of the folks here who were involved in the negotiation of the investment provisions of the agreement. We can certainly make them available to you.

I suppose the rationale of this particular provision was that these corporations are now totally Canadian owned and totally government owned and, therefore, if they privatize them there should be no obligation to make those available to foreign investors since there is zero foreign involvement in them at the moment.

Nevertheless, your point is well taken.

Senator **Murkowski**. If the situation were reversed here and Canada wanted to come in, would you advise the Secretary of Commerce to put a restriction on Canadian ownership, or would you say, hey, in the spirit of it is open and they can do whatever they want?

Ambassador **Yeutter**. I would do the latter, and it seems to me it would have been wise on the part of the Canadians to open up here as well.

Senator **Murkowski**. I know, but what happens in the future if the Canadians decide that since there is no foreign ownership they are just going to set this kind of a precedent and continue with it? Are you going to just acquiesce?

Ambassador **Yeutter**. This only applies to the crown lands.

Senator **Murkowski**. That is a lot of land, though.

Mr. **Reinstein**. In general in the investment chapter, the existing measures are frozen and can only get more liberal; that is, the prohibitions apply prospectively.

As far as existing restrictions which are much more liberal today in the energy area than they were in the past under the former National Energy Program, they cannot get any more restrictive than they are today.

So what we have is the most liberal regime we have seen in decades in energy investment in Canada in place, guaranteed that it will not be more restrictive than it is today, and may get more liberal. We did get some concessions up front, and there is no reason in principle why we cannot get more liberalization in the future.

Ambassador **Yeutter**. Just to give you a general response, Senator Murkowski, very quickly, because this is Secretary Baker's area here, as you will recall the Canadians had an immense number of restrictions on foreign investment. Secretary Baker and his colleagues at Treasury were successful in negotiating dramatic improvements in that investment regime as a part of the FTA, but they did not get all the way to zero in terms of investment restrictions, and this is one indication of where they did not.

So it is infinitely improved over the regime that was present before, but it is not as improved as we would ultimately like to see.

Senator **Murkowski**. According to Wall Street Journal, March 23, and I am sure you are familiar with the article with regard to the textile plant, it would appear to Congress to violate the spirit of the Trade Act and thus jeopardize passage. Terry Baker discussed the issue as recently as Monday. U.S. officials were taking some solace, however, that Ottawa had scaled down its original textile relief plan at U.S. requests.

So I assume we have intervened and said we do not like this.

Ambassador **Yeutter**. We did.

Senator **Murkowski**. They scaled it down.

It says, further, the administration likely will stress this point with angry congressmen.

I note you are stressing that there has been a relaxation in textiles, but is it to our satisfaction, and do you intend, Mr. Ambassador, to protest in the spirit of the FTA this energy agreement, or are we just going to take it?

It seems that you get somewhere when you enunciate your displeasure.

Ambassador **Yeutter**. There is considerable difference between the two. In our judgment, the one on textiles went far beyond what was intended. We had discussed the textile issue during the negotiations, and what was proposed then in the aftermath of the negotiations in textiles was far beyond what was intended.

We made that point clear in no uncertain terms, and our Canadian friends did alter the program dramatically and, in fact, included some provisions there that are clearly very favorable to the U.S. textile industry.

This one is somewhat different because what is being done in this area is clearly compatible with the provisions applicable thereto in the agreement itself. So I do not think we have a whole lot of cause to complain even though it is not a desirable situation.

Senator **Murkowski**. I think my question was do you intend to pursue this, though?

Ambassador **Yeutter**. We can pursue it in terms of these kinds of things clearly being an unsatisfactory way to proceed toward free and open trade, and also making the argument, which I believe is a valid one, that it hurts them more than it hurts us. I think investment restrictions hurt the person and the country——

Senator **Murkowski**. I agree with you, but Canada has lived with that restriction for a long time to their detriment, I think.

Ambassador **Yeutter**. Yes, to their detriment and their chagrin. We will keep trying to make that philosophical argument as well as the argument based upon the spirit of the negotiations.

Senator **Murkowski**. Speaking of the spirit of the negotiations, you may recall we had some correspondence concerning a 301 which your office was very effective in expediting. This involved unprocessed fish that previously, for example, if caught by United States fishermen, Canadian processors would buy them and transport them back to Canada and process them there. There is nothing wrong with that. That was fine, except our processors could not buy Canadian fish.

So we initiated a 301, and it was culminated in a GATT review panel determination that Canada's export ban was a violation of GATT. We thought, boy, that is great, that is the end of it.

This is not a big item on your agenda such as energy, but I think it is reflective of the problem that we have here with Canada and the efforts that they are going to circumvent the intent of our agreement. What they have done is they have implemented a new plan and new regulations requiring all Canadian-caught fish to be landed in Canada for inspection and grading before they can be exported. Now that is how they get around it.

Now, that simply means that if the Canadian fisherman is out there and he wants to sell to a United States buyer for processing in the United States port in Washington State or Alaska, he cannot do it. Those fish have to go back and be inspected and graded.

Now, Mr. Ambassador, are you going to support this administration requesting a reciprocity action against Canada so that we are back on an even basis, or do we just ignore that?

That puts us in a position where the Canadians can buy our fish from our fishermen and take it and process it and do anything they want with it, but we cannot do the same. That makes me very suspect, because they have sought to connive, if you will pardon the implications of that word, to beat a legitimate procedure under the agreed-upon negotiations under GATT 301 to get around an issue.

What are you going to do about it?

Ambassador YEUTTER. Senator Murkowski, we assuredly will not permit that kind of circumvention of a GATT finding to occur.

Senator MURKOWSKI. They changed the rules and regulations, so it is perfectly legitimate now because they are saying, hey, we have to take them back, inspect them and grade them before they can be exported.

Ambassador YEUTTER. Well, those changes have not yet been implemented. This is on our front burner, Senator Murkowski. In fact, I have had two discussions in the last five days with the Canadian Trade Minister on this.

As you know, Canada now has a new Trade Minister, Mr. Crosby, and so he is just getting up to speed on this and a lot of other issues.

I first raised it with him when he was here in Washington, DC, last week, and I raised it with him again over the weekend when we were in Vancouver for a trade minister's meeting.

I anticipate having further conversations with him on this issue soon. He knows my view with no question about the rationale of what we believe and the prospects of what might ultimately occur if our concerns are not alleviated.

I have indicated to Minister Crosby that Canada cannot expect to replace a GATT illegal export regime with an alternative regime that may be even more onerous and just as GATT illegal as the first one.

I indicated to him that we will scrutinize whatever emerges with very great care, and we will act accordingly in terms of protecting U.S. interests. That is as specific as I would like to be at this point in time, but I am sure that Minister Crosby understands full well the concerns that you articulated and that I share.

Senator **Murkowski**. I appreciate that, and I think your sensitivity to it has been gratifying.

I would assume that the new minister would have a hard time defending the particular action that had been taken to circumvent the true intent of what our negotiations were all about and would be somewhat embarrassed to try to defend that.

I guess, Mr. Ambassador, my only concern is if through your conversation the Canadian Government does not see fit to be responsive, what alternative do you have available?

Ambassador **Yeutter**. We have all the alternatives of section 301, of course.

Senator **Murkowski**. So you would anticipate having to go through that again?

Ambassador **Yeutter**. We hope we will not have to, but I just do not want to draw any premature conclusions because, to be fair, we have to give Minister Crosby a chance to do his own evaluation of this and some of the other issues that are on our bilateral agenda.

Senator **Murkowski**. Last, those of us who have a bit of a long memory and look at those charts concerning disposition and transportation of gas recall the ANGTS line and the whole justification for the Prebuild as to be a very temporary utilization of Canadian gas until such time as the Alaska natural gas line was built, because Canada under no circumstances wanted to be tied into the United States for any extended period of time selling its gas into our markets because they had other things they wanted to do with their gas.

As a consequence, we have seen the Prebuild built on down to Los Angeles and Spokane and the other leg through North Dakota, or I guess it is North Dakota.

The reality is the likelihood of Alaska gas being able to compete with Canadian gas and backed up by the reserves in the Canadian arctic.

For all practical purposes we have dismissed what was the objective and justification for the prebuilds to dependence almost totally on Canadian gas as opposed to—I am curious to know in retrospect how this came about.

The whole justification was Alaska gas, so we went ahead and convinced Canada that they had to build the prebuilds, and they reluctantly decided that they would provide gas until such time. Now when we want to export a little gas, the Canadians do not want any part of it because they are supplying gas.

It just amazes me how the tide goes in and the tide goes out.

Mr. **Martin**. Senator, as you know, the President recently made a finding that would allow the export of the Alaskan gas. He also said at the same time that this was not in any way to discourage development of the gas for the lower 48.

What the President sought to do was to seek any competitive alternative to move that gas because it is a major natural resource for this country, and the fact that it needs to be marketed is important.

Let me say that we worked together back in 1981 to get the waiver package through. The administration supported it; the Congress passed it. I think we had the best of hope that that gas would be marketed and brought down from Alaska to the lower 48 but, of course, the economics just turned against the project. Maybe some day it will be turned around.

But I think in some respects we are lucky to have the prebuild because we can at least benefit from some Canadian gas coming in.

I want you to know that while the government of Canada did object to the decision contained in the finding, they have not objected in tough terms. I think they were at least satisfied that we did not foreclose the possibility of that line being completed in the distant future as long as it was economic.

Senator MURKOWSKI. Mr. Chariman, I have a statement for the record that I would ask be entered.

[The prepared statement of Senator Murkowski follows:]

STATEMENT OF HON. FRANK H. MURKOWSKI, U.S. SENATOR FROM ALASKA

Mr. Chairman, I want to thank Ambassador Yeutter, and Deputy Secretary Martin for joining us today to discuss the United States-Canada Free Trade Agreement, I look forward to your testimony. When you last briefed the committee on the FTA, the formal agreement had not been signed. Perhaps today, some of the outstanding questions from that briefing can be revisited.

Since the intent to negotiate an FTA was announced at the Shamrock summit in 1985, I have been very supportive of its stated goals. As the largest two-way trading block in the world, the United States and Canada stand to benefit from an agreement which successfully removes tariffs and other barriers to trade. In addition, an across-the-board reduction of barriers enhances our influence in addressing trade barriers with other trading partners.

While I am supportive of the goals of the agreement, I remained concerned over its potential impact on specific U.S. industries. With regard to the energy provisions of the bill enhanced access to the United States market for Canadian energy exports is a laudable goal. However, unless we take action to insure that our domestic producers are not operating at a competitive disadvantage, the long-term viability of our domestic industry will be hurt.

I have some reservations about removing tariffs and other restrictions that have been enacted to counter subsidies given to Canadian producers, without receiving a commitment from Canada that these subsidies will be phased out. Especially in the area of transportation, such subsidies have given Canadian coal producers a big advantage over United States producers.

Finally, I am deeply concerned over actions taken by the Canadian Government which undermine the spirit of the FTA. For example in the areas of textiles and fisheries exports, the Canadian Government has proposed new restrictions which will negate concessions Canada made in the FTA. I don't believe such an agreement can work if there isn't a commitment to both the letter and the spirit of the agreement. I have recently sent a letter to Ambassador Yeutter expressing my concerns on this matter.

I am willing to examine this agreement on its overall merits. However, I must feel comfortable that the administration has carefully reviewed the impact of the FTA on individual sectors of the U.S. economy. I look forward to exploring these concerns with you today, and appreciate your efforts to consult with Congress in drafting the implementing legislation.

Senator MURKOWSKI. Thank you, gentlemen.

Again, I would just paraphrase briefly the consensus I have that you have done a great job for the consumer, but I am not so sure that the resource developer in this country is going to share the same degree of enthusiasm, nor am I convinced that you have the leverage after the fact to address the subsidies that the Canadian system enjoys.

Thank you.

Senator CONRAD. Thank you.

Ambassador Yeutter, we have had several sessions, one here and one previously in the Agriculture Committee. I have been interested in the discussions that we have had previously as to whether or not there are any studies that have been done on the differential effect for various industries in regions of the country based on the fallout from a free trade agreement with Canada.

Is there any differential analysis that has been done with respect to the oil industry, the coal industry or the natural gas industry that have been performed by your office that would tell us who the winners are and who the losers are, from the fallout of the agreement?

Ambassador **Yeutter.** We do not have a research component or analytical component of that magnitude in the USTR. There are folks in the U.S. Government who get involved in that kind of activity, basically the Commerce Department and the Treasury Department and the Council of Economic Advisers to some degree.

I am not sure whether we have anybody here today who can comment. I will let Bill comment on the energy side of things.

I will say there are lots of studies being done by a lot of people on the FTA generally, but most of them are overall aggregate studies rather than either regional geographic studies or industry-by-industry studies.

So it is a little hard to know what is available on a regional basis or on an industry basis.

The overall studies, of course, all show positive benefits to the FTA for both countries.

Senator **Conrad.** I understand that, but my question really goes to the question of industry-specific analysis. It would seem to me if we are negotiating an agreement that has tremendous potential effect on industries that are critically important to our country and our economy, we would have a pretty clear notion of the impacts at least with respect to aggregates as broad as coal or industries as broad as coal, oil, natural gas, and I would be happy to hear Bill's comment.

Ambassador **Yeutter.** Bill should comment here.

The short-run effect, of course, should not be very much because basically we have free and open trade in energy right now, but maybe Bill can comment a little more into the future.

Mr. **Martin.** Senator, of course, the circumstances of the industries differ across the board, but let us take natural gas for example.

We have started what we call a natural gas initiative to do two things. One is to clarify the resource base in the lower 48, which I think deserves some attention these days because we have the USGS over here, and we have Mr. Fisher from the University of Texas over here.

I think it is important for the Nation to know whether our natural gas base is adequate.

In addition, we are looking at the potential for natural gas to back out more imported oil.

As I have said before, one of the things I think this agreement does is to allow the consumer access to greater quantities of natural gas both from Canada and from the lower 48. I think that there is probably good news ultimately in this for the gas producers in the country because the consumers are going to be using a lot more gas, in my view. I think that is good for the country from an energy security perspective.

In the area of coal, we have already noted——

Senator CONRAD. Slow down a minute, if you will.

You have told me the effect on consumers. In addition to the effect on consumers, I want to know the effect on the domestic natural gas industry. What is the effect on the domestic oil industry? What is the effect on the domestic coal industry?

As you know, I represent a state that is heavily represented by all three, and I want to know if there has been an analysis that tells us what this does to our domestic industries.

Mr. MARTIN. OK. I thought I answered the point on gas.

Senator CONRAD. What I heard you saying was the effect on consumers.

Now, on the gas side I said I thought because consumers would have more confidence in the natural gas option because of more supplies that they would be using more gas in the future. That, in turn, will help remove part of the gas bubble that producers presently face.

If we can do some sensible things like continue to have open access, that will help even further, but I do not see that the gas producers are harmed in the short term. I think in the longer term because we use more gas, they will be helped.

The challenge, is in many of these areas we have so many different policies which infringe on gas producers. The fact that we removed FUA restrictions, for example, I think is a benefit to producers, and I think over the longer term gas producers are clearly not hurt but, in fact, helped.

Coal, we already sell them 16 million tons. I think the key issue for coal is what happens in your State, because this is the one state where some coal is being displaced from electricity imports, something on the order of 5 million tons.

We have done a short analysis, and we would be glad to provide it for the record for you, which actually shows that we are shipping some coal to provide that electricity, and it is basically a wash even in your part of the country.

Senator CONRAD. In my State it is not a wash.

Mr. MARTIN. You have lost 5 million tons. I am sorry. Over all it is a wash. In fact, over all we provide three times as much energy to them in coal than we are getting back in electricity. So that is the national perspective as a whole.

Senator CONRAD. You are talking history there, as I understand your comment. What happens in the future? Let me be specific.

We have a situation in which my coal industry is a mine mouth industry for the most part, lignite not shipped. We are in a mine mouth mode, and that makes us competitive on electricity sales. That is the final product.

They do not have one scrubber in the entire country, although they are very pious about talking about acid rain in that country. We are very interested and very concerned, deeply concerned, about what this does to us when they are able to put their electricity in without any chance to protect a market.

They have an enormous advantage having spent no money on scrubbers, and we have spent hundreds of millions of dollars in our state.

Mr. **Martin**. Let us remember that they attacked the environmental issue in a slightly different way. They do not require scrubbers, but they do have emission standards, and their emissions have fallen faster than those in the United States, I might add.

The way they do it is they have intermittent power. If they have a problem with the emissions, they just shut down for a few days. In fact, I have a very useful fact sheet which I would be glad to share with you.

Senator **Conrad**. When we say they have made more improvement than we have, does that take into account the base from which they start?

Mr. **Martin**. The aggregate SO2 percentage reduction has been higher. U.S. emissions have been reduced 20 percent, from 85 to 75, in Eastern Canada in this case 34 percent. So they have made some progress. They have a different approach than we take. They take more of a provincial approach to regulations.

Senator **McClure**. The intermittent controls may well meet ambient air quality standards at times of greatest impact, but they do not reduce total gross emissions. They want us to reduce gross emissions.

Senator **Conrad**. That is a point that really sticks in the craw of people in my State, because we have the Canadians talking about their emissions standards, but we live south of one of their plants and when that sucker is on, it is a full polluter, and there is nothing to stop it.

So they have been very clever, I must say, at regulating emissions by turning the plant off and on. When it is on there is nothing stopping the effluent.

All across Canada it is the same way. All across Canada there is not scrubber one. So we are deeply concerned about the displacement that that causes in our part of the country.

Ambassador **Yeutter**. I was just going to add one point, Senator Conrad, if I could while Bill is thinking about anything else he might want to add here. That would be that all of this is obviously of great relevance to you, but it is unaffected by the FTA; in other words, none of this is in any way affected by the provisions of the Free Trade Arrangement.

Senator **Conrad**. Well, are we not taking away any opportunity that we would have in the future to deal with the environmental difference; that is, would we be precluded as a result of this from putting into place an amendment that would say their power can only come into this country to the extent they have met the same clean air standards that our plants are expected to meet?

Ambassador **Yeutter**. I will let Mr. Roh comment because that is a legal question.

My understanding would be that as long as we provide national treatment, if we have a legitimate reason to apply restrictions or requirements of this nature, as long as we treat Canadians the same way we treat Americans in the application of the requirements and we have a legitimate basis for the requirements, we can do so.

But let me ask Mr. Roh to challenge that if he wishes.

Mr. Roh. There was something about that introduction.

I am not quite sure I understand. Are you saying that we should require that Canadian energy cannot be imported unless it is produced under the same environmental requirements that we have?

Senator Conrad. Correct; unless they meet the same standards that our plants are asked to meet, that they not be able to come into this market. That is what is called a level playing field in the parlance of Washington.

Mr. Roh. Yes, sir. I think it would probably violate our international obligations. I have to say I hope it would, because if the Canadians take the perspective that they will not import anything from us until we have cleaned up enough acid rain to meet their desires, the trade would pretty much stop.

Ambassador Yeutter. We would have a problem with going——

Senator Conrad. Well, wait a minute, now. I want to get it straight between the two of you. I have heard two very different things.

Ambassador Yeutter. That is why we have to be specific about what is intended, because we have to be careful we do not impose our own view of the world on everybody else. That gets us into trouble. We cannot go around the world saying that everybody else must do things precisely the same way we do.

Senator Conrad. No, we would not be imposing our view on them. We do not tell them what to do. We simply say we are not going to take your power into our country unless it meets the standards that our power generators meet.

Ambassador Yeutter. As I said, we would probably violate our international obligations if we did that, Senator Conrad. We would object with great vigor if other countries did that to us.

Mr. Martin. May I make one comment? I kind of agree with the Senator, not with what you are saying legally, that we should prohibit because of the environmental standards, but let us face the fact. The Canadians have made quite a big issue about acid rain and what we should do. Whether it is a legal issue or not, I judge that the Ambassador and Mr. Roh are qualified to decide. I think we have an obligation to make sure.

The special envoy's report, for example, that came out three years ago which the President endorsed, launched the $2.5 billion clean coal program. We are making a major commitment in this country towards clean coal technology, and I think that maybe on a political level we have to ask the same of our friends from Canada.

They continue to hit us on this again and again and again, and I think we have a political obligation, if not a legal one, to go back to them and say we are going to do our share but you have to be a good neighbor on this, too.

So I think that is where you are coming from, and I think that is where Senator McClure is coming from, who has heard a lot about clean coal over the last few years.

From an energy perspective, I might add, I still think clean coal is the way to go as opposed to more stringent environmental regulations governing emissions from our powerplants. Of course, we have told that to the Canadians, and they are disappointed in that decision because they would like to see an absolute reduction in the level of emissions crossing the border.

We point out that we have made improvements over the last decade.

Well, I will not go on about it. It is inappropriate in this hearing. But I get the sense of what you are saying, and I think the thrust of it is fair is fair and let us do better on both sides of the border.

Senator CONRAD. I have absolutely no quarrel with our doing better. We know we have to do better.

But for those of us who have been hit repeatedly and who look to what has happened in our individual states, in my state we have spent hundreds of millions of dollars cleaning up. It sticks in our craw when our friends across the border—and we consider them our friends—come with hands that have not exactly been washed, with not scrubber one in the entire country, and they come to us and tell us we are dirty. That is hard to take.

Let me conclude this part of my questioning by making certain I get an answer to what I have tried to obtain an answer on, and that is the question do we have industry-specific analysis if not in your office in other places in the Federal Government that would give us a clear indication of the effect of this agreement over the next five years, 10 years, whatever the timeframe might be?

If so, could we obtain those?

Ambassador YEUTTER. We will try to see what we can generate for you, Senator Conrad. We do have the U.S. International Trade Commission study on the impact of the tariff activities, but that has no effect of consequence here. It does in a lot of other industries.

There has to be considerable——

Senator CONRAD. Let me ask it in a different way.

Are you aware of any specific analysis that has been done on a major industry basis, any study that has been done by Commerce or by Energy on the effect of this agreement?

Mr. MARTIN. We have tried to look at, for example, the impact on the coal industry, and concluded that less than 1 percent of our U.S. coal production would be displaced by imported power under this agreement.

Now, that gives you an example. One could translate that into jobs and so forth. It is still a very, very small percentage.

Overall, I think we believe the coal industry benefits because of the exports that are going to Canada, but it is that order of magnitude. We would be glad to provide you the analysis we have done, what our projections are and how much domestic gas will be displaced in others.

[The information follows:]

How Free Trade with Canada Affects the U.S. Coal Industry

THE CURRENT TRADE SITUATION

Canada is the largest single export market for U.S. coal.
In 1986, the United States exported 14.7 million tons of coal to Canada and imported 0.3 million tons. Net exports to Canada were thus 14.4 million tons. About half of our coal exports consist of metallurgical coal for smelters, and the remainder consist of steam coal destined for Canadian electric utilities. These exports amount to roughly 2 percent of the industry's overall coal production. In all, they account for over one-sixth of our coal exports on international markets.

Coal exports to Canada create jobs and income in Appalachia.
In 1986, West Virginia exported 7.4 million tons of coal to Canada, adding 1,900 jobs and $230 million of income to the state. Kentucky exported 2.8 million tons, adding 700 jobs and $70 million of income. Pennsylvania exported 4.5 million tons, accounting for 1,300 jobs and $140 million of income. This coal is mainly used for power production and smelting in the Canadian province of Ontario.

Electricity imports from Canada mainly reduce oil use, not coal use.
In New York and New England, which account for nearly three-fourths of power imports from Canada, most power imports displace imported oil. In 1986, the use of Canadian electricity reduced U.S. oil imports by some 120,000 barrels per day . Despite the importation of Canadian power, the Northeast remains reliant on oil for roughly a third of its electricity generation. Hence, there is ample opportunity for continued oil displacement through increased use of coal.

A significant portion of imported power is generated from U.S. coal.
In 1986, over 5 billion kilowatt-hours of imported power, or one-seventh of the total 35 billion kilowatt-hours imported, was produced in Canada from U.S. coal. The resulting contribution to U.S. coal exports exceeded 2 million tons.

Only in the Upper Midwest is coal displaced by imported power.
In 1986, the Upper Midwest imported roughly 7 billion kilowatt-hours of electricity from the Canadian province of Manitoba. If this imported power had not been available, domestic power generation would have required an additional 5 million tons of North Dakota lignite and other Western coal.

On balance, trade with Canada has helped the U.S. coal industry.
Our exports of coal to Canada are roughly triple the amount of coal that is displaced by the importation of Canadian electricity. The net effect of trade with Canada is thus to increase production and employment in the coal industry.

FUTURE TRADE PROSPECTS

Opportunities exist for the expansion of coal exports to Canada. *The main Canadian market for U.S. coal is Ontario, where coal accounts for more than a fifth of electricity production. Most of Ontario's power is nuclear or hydroelectric, but its hydro resources are almost fully developed, and there are major political and regulatory barriers to expansion of its nuclear program beyond plants now under construction. Hence, a significant portion of electric demand growth in Ontario may well be met by coal-fired power. While some of this growing market may continue to be supplied by coal from western Canada, it could also be met in part through increased exports of competitive coal from the eastern United States.*

Electricity imports should not displace much coal in the Northeast. *There has been some speculation that imported Canadian power is being used to delay construction of coal-fired power plants in New York and New England. However, the amount of power that the Northeast is likely to obtain from New Brunswick, Quebec, and Ontario is significantly less than the amount of new electric supply that the Northeast is likely to need by the end of the century. Hence, despite anticipated growth in electricity imports, there is ample opportunity for sale of coal by wire, as advocated by Governors Moore and Sununu, as well as construction of new coal-fired plants in the Northeast. Furthermore, if transmission links with Canada are strengthened to allow increased electricity imports, they will also allow increased electricity exports to help meet Canada's peak power needs in the winter, and these increased exports would largely be generated from U.S. coal in the Midwest.*

THE ROLE OF THE FREE TRADE AGREEMENT

The Free Trade Agreement will have little immediate impact on the U.S. coal industry. *There are no restrictions on coal exports into Canada. Neither are there major practical restrictions on electricity imports from Canada. The Free Trade Agreement may facilitate power imports by eliminating the requirement that the power be certified as surplus to Canadian needs, but the overall level of imports will not clearly be increased to any significant degree.*

However, the atmosphere created by the Agreement is conducive to expansion of Canadian markets for U.S. coal. *In this environment, future restrictions on coal exports to Canada, as well as efforts to protect uncompetitive coal in western Canada, will be strictly prohibited. The coal industry will thus be well placed to move into growing Canadian markets.*

Notes on

"How Free Trade with Canada Affects the U.S. Coal Industry"

Data on levels of U.S. coal exports to Canada

Data obtained from Energy Information Administration. Data shown by production district in Coal Distribution Report were converted to state figures based upon production patterns shown in Coal Production 1986 (forthcoming).

Data on jobs associated with U.S. coal exports to Canada

Data on production and employment in the coal industry in each state were obtained from the Energy Information Administration. These were used to calculate production per miner. Dividing tons of coal exported by production per miner, it was possible to obtain the number of jobs associated with exports.

Coal State and Type	Production (Thousand Short Tons)	Number of Miners (Average)	Production Per Miner (Short Tons)	Coal Exports (Thousand Short Tons)	Jobs from Coal Exports
W. Virginia	129,264	33,540	3,854	7,407	1,922
E. Kentucky	111,196	26,021	4,273	2,801	655
Pa. Bituminous	66,736	17,814	3,746	4,143	1,106
Pa. Anthracite	3,828	1,935	1,978	355	179

Data on income associated with U.S. coal exports to Canada

Data on the minemouth price of coal in each state were obtained from the Energy Information Administration. These prices were multiplied by export levels to obtain estimates of the income derived from exports. These income estimates are conservative as they exclude transportation costs and markups.

Coal State and Type	Minemouth Price Per Short Ton	Coal Exports (Thousand Short Tons)	Income from Exports
W. Virginia	$30.90	7,407	$229 million
E. Kentucky	$26.13	2,801	$73 million
Pa. Bituminous	$29.50	4,143	$122 million
Pa. Anthracite	$44.12	355	$16 million

Data on levels of U.S. electricity imports from Canada

Data obtained from Canadian National Energy Board.

Data on coal displaced by U.S. electricity imports from Canada

The Mid-Continent Area Power Pool (MAPP), in which the Dakotas and Minnesota are located, has estimated the use of 52.6 million tons of coal in 1986 to produce 77.6 billion kilowatt-hours of electrical energy. This works out to 0.68 million tons of coal per billion kWh of electricity generated. Purchases of Canadian power in the U.S. Upper Midwest amounted to 7.1 billion kWh in 1986, of which 7.0 billion kWh came from Manitoba and 0.1 billion kWh from Sskatchewan. Multiplying the 7.1 billion kWh by 0.68 million tons per billion kWh generated, coal displacement is found to be roughly 5 million tons.

Data on oil displaced by U.S. electricity imports from Canada

Purchases of Canadian power in the U.S. Northeast amounted to 26.1 billion kilowatt hours in 1986, of which 12.6 billion kWh came from Quebec, 6.8 billion kWh from Ontario, and 6.7 billion kWh from New Brunswick. Assuming a heat rate of 10,000 Btu per kWh in a typical oil-fired powerplant and 6 million Btu per barrel of oil, there are roughly 600 kWh produced from a barrel of oil. Since most of the power displaced oil, Canadian imports displaced 26 billion kWh divided by 600 kWh per barrel, or 43 million barrels of oil in 1986. Dividing by the 365 days in a year, this works out to roughly 120,000 barrels of oil per day.

Mr. MARTIN. It is important to remember that so much of this will actually in the long run displace some of that imported oil from more insecure sources. So we do not see it as a real displacement of our energy resources.

The quantity is not that big to really pose a serious challenge. The much greater challenge is in the clean coal area, for example. In the uranium industry, we think the greatest problem is the market for uranium.

Senator CONRAD. Let me follow up, Bill, if I might.

Do you know where the 1 percent displacement occurs; that is, is this study sophisticated enough to tell us if we are going to get 1 percent displacement where that displacement is likely to occur?

1 percent nationwide could translate into 25 percent in an individual state, and then we are talking about something that is a very serious matter for some of us.

Mr. MARTIN. I am told that 1 percent has already been displaced, it is primarily in your State.

Ambassador YEUTTER. There have to be some Commerce Department studies available, too, and we will try to drum them up for you, Senator Conrad.

Senator CONRAD. One thing that disturbs me is we have negotiated an agreement I think in good faith, I think with the best of intentions. I happen to think you have done your very best.

As you know, I am not terribly pleased with the outcome, representing the part of the country which I do, but if we negotiate an agreement without having major industry analysis as to how this agreement affects those industries, my concern is heightened.

Ambassador YEUTTER. Well, Senator Conrad, you must remember we have 1,000 private sector advisory committee people who have been involved in this process, between 40 and 50 committees representing every conceivable industry around. We have been listening to them during the entire process.

Now, that is not to say that we have followed their advice on all aspects, but we have had a lot of advice.

Senator CONRAD. I am hopeful we are going to have a hearing like this in the Agriculture Committee. Are you looking forward to that?

Ambassador YEUTTER. Oh, I am ready for that one because that one is easy.

Mr. REINSTEIN. Let me just comment a minute on whether we had any idea what would happen in the energy sector as a result of what we were negotiating. In fact, we had a pretty good idea what would happen because we looked at what the barriers to trade between the United States and Canada are today and said with respect to each of these barriers what is the likely impact of dealing with it under the FTA.

I think you can say certainly over the short to medium term, that is the impact of the FTA. In fact, there are hardly any barriers. There are a few explicit barriers; for example, the export restriction on Alaskan oil.

We allowed Canada to have up to 50,000 barrels a day of Alaskan oil. We had an analysis of what the impact of that change would be. That change could result in the loss of something a little bit more than 100 maritime jobs.

We had analysis. We had some idea of the impact where we dealt with specific barriers. Where no barriers existed, our conclusion was we should not see an impact of the FTA, simply saying that the current situation will continue unless you believe and you take as an assumption to your analysis that in the future we would impose trade restrictions. Then you would have to hypothesize some different situations where trade restrictions would exist that do not exist today in order to get impacts as a result of preventing them.

Senator CONRAD. Could we have that specific analysis to which you have just referred on those items?

Mr. REINSTEIN. I think we can go down the specific items we addressed in the energy chapter, and they are listed basically in the appendices; that is, the actual things listed in Annex 902.5 and 905.2 to the energy chapter, the actions actually taken dealing with existing barriers, and make some assessment——

Senator CONRAD. Do those things provide the analysis itself? Do they provide the actual steps taken?

Mr. REINSTEIN. Those annexes do not provide the impact analysis, but they specify the actions that each country will take in order to implement the agreement. Those are the changes in the effects of the agreement in the energy area.

Senator CONRAD. Were those driven by specific impact analysis, the steps that were taken?

I assume they flow from something. I mean, somebody sat down and said here is what happens if we do A, B, and C.

Mr. REINSTEIN. The decision to address the few barriers to energy trade that exist today was driven from a fundamental premise that it was in both countries' long-term clear mutual interest to have the freest possible trade in energy.

In that kind of analysis, you just look at the geographic situation, the geology, the relative long-term energy dependence that both of us have on imports, and say obviously to the degree we have the most economically efficient energy system in the two countries, the better off both of us will be; therefore, whatever we can do to eliminate barriers to the bilateral energy trade will be to our mutual benefit. That is what they were driven by.

Senator CONRAD. Let me pursue one other point and then turn it over to Senator McClure.

Currency differentials are something that have been discussed at some length. We are very interested in whether or not you took into account currency differentials, whether or not there is a management of currency, the currency differential going on by our neighbors to the north, and what are the effects of the currency differentials in the energy area?

Ambassador YEUTTER. We did not build any provisions related to exchange rates into the agreement, as you know. They were deliberately excluded and will be from any other agreements that we negotiate because we believe that it would be improper to have them included.

Exchange rates are volatile and will always be volatile, as you know.

Senator CONRAD. Clayton, what if somebody is managing their currency? That is to our detriment. We know what is going on around the world.

We know that there are countries that have been very clever about maintaining market share here. They have watched the dollar come down, and they have moved their currency down in parallel in order to retain market share.

To the extent somebody does that, the rest of what we are talking about here becomes a whole lot less relevant, does it not?

Ambassador YEUTTER. That is correct. If and when that occurs, and it does occur sometimes as you indicate, then we should attack that phenomenon with vigor. I hope we are doing so.

Senator CONRAD. Did we look at that with respect to our friends to the north?

Ambassador YEUTTER. Yes. This is Secretary Baker's area of responsibility, of course, but he is satisfied that that is not a problem and has not been a problem in our relations with Canada and is not likely to be a problem in the future.

If it does pose a problem in the future, why obviously we will deal with it at the time. We need not deal with it in the FTA. We have plenty of other avenues in which to undertake that debate.

So we were not concerned about trade distortions as a result of managed currencies in the United States-Canada Agreement.

Senator CONRAD. If you look at what has happened to Canadian currency vis-a-vis the American dollar, even with the steep slide in the dollar there has been virtually no change in the differential with Canada.

Ambassador YEUTTER. It has been rising. The Canadian dollar is stronger now than it was when we negotiated the agreement. So it has been strengthening in value. We believe that reflects the underlying fundamentals.

Treasury has watched that situation carefully. If you wish, Senator Conrad, we would be happy to get you a Treasury Department briefing on it.

Senator CONRAD. I would be very interested in that.

Obviously in our border position, we feel very directly these currency differentials and the effect that they make on our business community.

I must say we have more skepticism than I think you have indicated on the question of whether there is some management of the currency going on on the other side. We have seen the dollar come down 50 percent on a market basket approach, and Canada has not come down measurably.

That has a tremendous effect on our ability to be on an equal footing and a competitive basis.

Finally, I cannot let go the comment on agriculture because, as you know, in my constituency, I will tell you, there is no group who is more convinced that they are adversely affected than the grain producers of my state and the grain producers around the rest of the country.

They look at that transportation subsidy not counting, and they look at Canada making a move by saying we are going to phase out the transportation differential to the west and not do anything to the east. They see the two-tier marketing program that they have in Canada as something that is not counted in the subsidy differential.

They think, hey, wait a minute, we are opening our market to them and they keep theirs closed to us even though there is a fig leaf that makes it appear something is going to happen in the sweet by and by. They are interested in the here and now.

Especially on the transportation matter which is of relevance to this committee as well, there is tremendous skepticism and a feeling that we just have not cut a fair deal with respect to that transportation subsidy. You have heard it from others; you should hear it from me as well.

I would be interested in your response on that.

Ambassador YEUTTER. My comment there would simply be that they are completely wrong in the transportation matter because they are in no way disadvantaged as compared to the status quo. Those transportation subsidies are in existence today and have been in existence for a long period of time. The FTA simply just does not change them any.

So they certainly cannot argue that the FTA has in any way worsened their lot because they have been around for a long time.

Senator CONRAD. That is a very good answer, but it does not go to their argument. Their argument is this. We are going to have free and open trade to the extent we have equal subsidies or equivalent levels of subsidy, and this is a subsidy that is not measured anywhere. Our direct payments count; this indirect does not.

Ambassador YEUTTER. My answer to that is that it will not be a perfect world in the United States-Canada trade after this agreement goes into effect. It is not a perfect world now. We think it will be a little more perfect as a result of the FTA, but not utopian.

I think some of our agricultural friends had utopian aspirations, and those were not realized. But those of us who evaluate these kinds of things have to recognize that the proper comparison is is it better than before, and if it is better than before maybe it is worth doing.

In fact, in agriculture it is better than before. Our agricultural friends forget some of the good things that are in the FTA for them, and they concentrate a little too much on some aspirations that were unrealized.

I think if we can get them to focus——

Senator CONRAD. This is a discussion I would like to continue in a different forum.

Just for your knowledge, I have today requested that the Chairman of the Agriculture Committee convene hearings on this matter, because I think it is important in that form as well.

Ambassador YEUTTER. I hope he does. We have already done it in the House Agriculture Committee, and so I think we should do it in the Senate Ag Committee, too.

Senator CONRAD. I appreciate that.

Senator McClure.

Senator McCLURE. Thank you, Mr. Chairman.

Ambassador YEUTTER. The privileges of the ranking minority member.

Senator McCLURE. Well, Mr. Ambassador and Mr. Secretary, you have been very patient. You have now been here over three hours, and I do not mean to burden you but I do have some questions I would like to ask and then submit some others for the record.

I might just ask in connection with the latter comments involving both transportation and agriculture, what happens to the beef import quota under this legislation?

Ambassador YEUTTER. We each exempt the other from our respective import quota programs. In other words, there will be no quotas on United States beef going into Canada. There will be no quotas on Canadian beef coming into the United States.

Senator McCLURE. So to the extent they are affected by existing law, those quotas are wiped out on both sides?

Ambassador YEUTTER. Correct.

Senator McCLURE. I have three general questions.

First of all, what does that pretty chart mean? Gee, the colors are gorgeous, but I cannot quite tell what the chart means.

Ambassador YEUTTER. Your turn, Scott.

Mr. CAMPBELL. The chart means that we are going to have to rely more on natural gas and on secure oil from places like Canada in the very near future because we have an 8 to 10 million barrel a day gap.

Senator McCLURE. What are those little red blocks that say "oil gap"?

Mr. CAMPBELL. Well, the first oil gap, as you might recall, occurred in the 1970's because we were heavily dependent upon imported oil, and we are moving in that direction in the 1990's. Once again, we enter a period of vulnerability to supply interruptions because of an 8 to 10 million barrel a day import dependence.

Senator McCLURE. I notice it starts in the early 1990's and ends before 2010.

Mr. CAMPBELL. That is a 100-year life cycle that runs from the beginning of the oil and petroleum economy in this country and runs out to about 2020, when we hope there is a breakthrough of an alternative fuel that solves some of our problems.

Senator McCLURE. What causes the gap to end?

Mr. CAMPBELL. The gap will never end, but you have to move away from petroleum in automobiles, basically.

Senator McCLURE. All right. You say the gap will never end, but that chart shows it ends. [Laughter.]

Mr. CAMPBELL. We ran out of space. [Laughter.]

We would be happy to submit a longer chart for the record.

Senator McCLURE. I never would have believed that the government ran out of red ink. [Laughter.]

You should have put that red right over to the righthand side of the chart, should you not?

Mr. CAMPBELL. Our hope is that there will be a movement toward alternative fuels, and there will be some scientific breakthroughs that would help us.

Senator McCLURE. I understand that. I occasionally have hopes around here, too.

Mr. CAMPBELL. It is a very idealistic chart, Senator.

Ambassador YEUTTER. Those may be some more unrealistic aspirations, Senator McClure.

Senator McClure. I just wondered, because I could make no sense out of that, seeing that sometime before 2010 we have somehow gotten out of the second oil gap.

Mr. Campbell. I think it is too late after that point. We will see.

Senator McClure. I was really groping. If you know something I do not know, I would sure like to hear it because I do not see that oil gap ending.

Mr. Campbell. The way you deal with that oil gap is, you have to stimulate domestic oil production, rely more heavily on natural gas. We think that natural gas can expand market share with the help of the Free Trade Agreement and back out or a million barrels a day of insecure oil. That is one way to help.

Senator McClure. We know what caused the end of the first oil gap, do we not? An economic collapse in the free world, partly stimulated by overdependence upon imported oil and a tremendous increase in price. We just priced it out of the market, and all of a sudden we had enough.

Is that what you are planning on early in the next century?

Mr. Campbell. I think we have had a lot of conservation. We use less oil today than we did in 1973 and less total energy than we did in 1973.

But that is not going to happen anytime soon. The worst problem we have now is that production declined, as you can see in the chart. We did not have that problem before, and now we have it.

Senator McClure. Well, it is worse now.

Mr. Campbell. Yes, it is.

Senator McClure. We had it before, and it is worse now. I do not see an end to that. As a matter of fact, your chart does not show an end to it. It just shows production keeps on sliding, consumption keeps on rising, but the gap ends.

Mr. Campbell. No, the chart runs out. We could certainly extend the red beyond that.

Senator McClure. That is what intrigued me, because I could not quite figure out what caused an end to what looks like, by the other lines on your chart, the end to the continuing problem.

Mr. Campbell. The answer, just briefly, is there are a lot of options that do not come into play in time. Alternative fuels, enhanced oil recovery, breakthroughs of that nature could help us beyond 2010.

Senator McClure. Senator Conrad really came up with it. The real answer is the chart is wrong.

Mr. Campbell. I am not so sure it is wrong, but the point we tried to make with the chart was, we have a period of vulnerability that runs throughout the 1990's to about 2010, and some of the options that have been suggested, like alternative fuel for transportation, do not help us in time.

They might be able to help us solve our problems in 2010, but they are not going to do it over the next 10 to 15 years. That was the reason we had it structured the way it is.

Senator McClure. I want to know a little of the basis of the Free Trade Agreement. Is this a treaty?

Ambassador Yeutter. I will let Chip answer, since that is a legal question.

It is not a treaty but it is an executive agreement, as I understand it.

Chip, is that right?

Mr. Roh. Yes, it is an executive agreement.

So this does not override existing law. You can override it, but you need congressional approval and you have to indicate what your intent is. Are you intending to override the existing law?

Senator McClure. So the laws that exist today, unless they are specifically identified, remain in effect?

Mr. Roh. Yes. By the fast track process, what we will be doing is submitting the agreement for approval along with implementing legislation to change the laws.

Senator McClure. But to the extent the agreement and the implementing legislation does not change existing law, existing law remains unchanged?

Mr. Roh. Yes, sir, that is right.

Senator McClure. It gets back into the question of what happens to FERC Order 256.

As an example, I am intrigued by the Ambassador's letter which the distinguished Senator from Louisiana put in the record earlier. It says it does nothing to Order 256 as to the as-billed decision, and I contrast that with the letter he wrote to me dated January 27, 1987 which, as I read, he is taking vehement exception to Order Number 256 as being discriminatory.

I would not attempt to characterize all the verbiage that he used, but I do not see how in the world you can come to the conclusion that if, indeed, his letter of January 27, 1987 was correct that somehow that does not contravene the terms of this agreement. So I hope he has changed his mind is what I am really trying to say.

Ambassador Yeutter. Let us see if anybody would like to comment on that.

Bob?

I guess we will not psychoanalyze those differences at the moment.

Senator McClure. I do notice on page 142 of this publication, the Free Trade Agreement, where they say,

> The chapter recognizes the important role played by the National Energy Board in Canada, the Federal Energy Regulatory Commission and the Economic Regulatory Administration of the United States.
>
> If discrimination inconsistent with this agreement results from a regulatory decision, direct consultations can be held with a view to ending any discriminatory action such as the decisions earlier this year by the Federal Regulatory Commission prohibiting Canadian suppliers of natural gas from passing all their shipping costs onto their customers.

Now, that is prospective, not retrospective, and as I understood your answer earlier, Order 256 would not be directly affected, but a future action similar to Order 256 might trigger some response under the agreement.

Am I correct?

Ambassador Yeutter. That is correct. I believe Mr. Reinstein said that theoretically the government of Canada could challenge 256 under the dispute settlement process.

Senator McClure. Even though it is ongoing?

Ambassador Yeutter. Even though it is ongoing.

But he said that he did not believe they could do so successfully.

Senator McClure. Mr. Edge, testifying on February 10, 1988, makes the following statement: "The Canadian Government regards the application by the FERC of Opinion Number 256 to imports of Canada gas as being inconsistent with the FTA."

It has been suggested that he is only a private citizen and he does not know what he is talking about or if he does know what he is talking about it does not apply to the government.

I would refer to a press release dated January 26, 1988, which is a release of the Canadian Government, and refer to its comments about Order 256. They are the same as those of Mr. Edge.

So I am not really certain that saying Mr. Edge is just a private citizen and does not know what he is talking about really answers the question when the government up there apparently agrees with him.

Ambassador Yeutter. I would like to ask Bob if he would like to comment on that.

Mr. Reinstein. Senator, I did see those comments of Mr. Edge. What he noted in citing the government's view was this paragraph that you read where they referenced that as an example of a kind of discriminatory rule which would refer to the consultative mechanism.

Senator McClure. All right, and that consultative mechanism is what?

Mr. Reinstein. It is a consultative mechanism.

Senator McClure. We consult with them; if we do not like the results, then we go to arbitration?

Mr. Reinstein. That is right. In other words, it is an opportunity for the experts, the agencies with expertise in energy, to get together and examine the issues and hopefully communicate to see where there are some misunderstandings that have arisen that could be resolved.

Senator McClure. Now, can I just take Order 256 as an example of how that might work?

They do not like what FERC has done in Order 256. They have made no bones about that. So they decide to consult with us. As a matter of fact, I think it is fair to say we already have. We are in disagreement. They do not like it; we like it.

So it is submitted to arbitration. The arbitration goes forward and comes out adverse to the United States.

Then FERC is directly overturned as a result of that arbitration?

Mr. Reinstein. No, they are not.

Senator McClure. What happens? The arbitrators say, United States, you are wrong.

Mr. Reinstein. We have two choices there. One is, of course, to conform the rule. Here we are not talking about 256. We are talking about some other hypothetical rule.

Senator McClure. Well, you have indicated that they can still go back and do that, hypothetically.

Mr. Reinstein. As I say, in the case of 256 we do not view it is as inconsistent with any of the provisions of the agreement, and neither does the Canadian Government.

Senator McClure. That does not answer the question.

Ambassador **Yeutter**. Assume that we lose the arbitration under 256.

Mr. **Reinstein**. There are two choices. One is that FERC can change the rule to conform to the principles of the agreement.

Senator **McClure**. They do not lose that way. I have tried that with my——

Mr. **Reinstein**. The other possibility is that if they do not do that, we would owe Canada compensation or they would be entitled to retaliate against us by withdrawing some other concessions in some other area of the trade.

Senator **McClure**. If at the end of arbitration that was the result, that Order 256 is discriminatory, and we do not elect to rescind Order 256 or modify it, then they can take actions that are retaliatory or compensatory according to the terms of the agreement?

Mr. **Reinstein**. That is correct.

Ambassador **Yeutter**. That, of course, applies to all dispute, Senator McClure, as you might expect. That is not peculiar to 256 or even peculiar to the energy area, although some of the others may be handled somewhat differently.

Senator **McClure**. That would be true of any Federal law or Federal regulation?

Ambassador **Yeutter**. That is correct.

Senator **McClure**. You go through the process of consultation; you go through the arbitration; if we are found to be wrong in that process and we do not conform, then there is the other compensatory or retaliatory action?

Ambassador **Yeutter**. That is correct. It is not quite that simple, of course, and Chip is chomping at the bit to provide the qualifications; but that is the essence of the process.

Senator **McClure**. All right, because there are a whole lot of differences and variations, and I do not want to try to dot every "i" and cross every "t", but I do want to understand where we may come out.

So the Free Trade Agreement does provide a basis for challenge of actions. It does not provide a basis for a challenge in the U.S. courts or Federal or State laws?

Ambassador **Yeutter**. That is a legal question. It is much more complicated. Let me ask Mr. Roh to respond.

Mr. **Roh**. Senator, that depends in part on what is worked out in the legislative process.

Senator **McClure**. So we do not yet know?

Mr. **Roh**. An executive agreement approved by Congress as a normal matter of judicial interpretation probably would be found to prevail over inconsistent State law.

Senator **McClure**. But does it give them any right in our courts?

Mr. **Roh**. Private right of action depends on what you do or do not say in the legislation.

Senator **McClure**. Let me rephrase the question. Does the Free Trade Agreement provide the basis for a challenge of Federal or State law? The answer, I think, is yes.

Mr. **Roh**. It really depends on what you do in the implementing bill.

Ambassador **Yeutter**. It could, Senator McClure, but it does not necessarily do so.

In other words, we can have Federal preemption here of State laws, but we need not necessarily do so.

Senator **McClure**. But if a Federal or State law were found to be discriminatory, will it provide an independent challenge to that law or regulation, or does it depend totally upon retaliation and compensatory actions?

In other words, if somebody thinks the Federal or State law or regulation discriminates against Canada in ways that violate the Free Trade Agreement, is that the basis for a challenge of the Federal or State law or regulation?

Mr. **Roh**. If we so provide in the legislation.

Senator **McClure**. But you cannot answer that question until the legislative package is submitted to us; is that correct?

Mr. **Roh**. That is correct.

Senator **McClure**. We will see that sometime around June 1?

Mr. **Roh**. Well, we will be discussing it, Senator, well before that.

Senator **McClure**. I am discussing it right now, and I am getting nowhere.

Ambassador **Yeutter**. That is because those are all open questions yet, Senator McClure.

Senator **McClure**. Well, I understand that if you cannot answer the question because it has not been decided, obviously you cannot answer the question because it has not been decided. That is one of the questions I think you need to answer for us, whether or not we are creating a new class of actions or a set of actions in our courts to challenge the application of Federal or State law or whether it is simply a recourse to retaliation or compensatory action.

Ambassador **Yeutter**. Sure. We obviously have our own views on that, but Mr. Roh just does not want to say anything that would preempt the Ways and Means and Senate Finance Committees or anybody else over here because this has to be worked out together.

Senator **McClure**. Senator Ford noted earlier that they do not have enough votes to pass this.

Ambassador **Yeutter**. Yes.

Senator **McClure**. I would invite you to consider the fact that they are a very important part of the Congress but not an exclusive part of the Congress.

Ambassador **Yeutter**. We recognize that, Senator McClure.

Senator **McClure**. I am not sure they do. [Laughter.]

The staff is mystified, and I do not like a mystified staff. They understood Mr. Reinstein to indicate that if an order like Order 256 were to be promulgated today, it would be violative of the terms of the FTA.

Ambassador **Yeutter**. Oh, no.

Mr. **Reinstein**. No. I said, to the contrary, I do not believe it is inconsistent with any provision in the FTA. In fact, it applies the same rules to all gas, both Canadian and U.S. gas, and in that regard is fully in conformity with national treatment specified in Chapter 5. I see no provision with which it is inconsistent.

Senator **McClure**. You think the Canadians are just dead wrong on this issue?

Mr. REINSTEIN. Well, let me explain. There are two bases for challenge. There is challenge on the basis of inconsistency with specific provisions of the agreement. We see no specific provisions of the agreement that it is inconsistent with.

There might also be a challenge under the general concept of nullification or impairment of rights or benefits which either party might have expected under the agreement whether or not there is an explicit violation of the specific principle.

I think with regard to that second category of challenge, the negotiating history guides us here, in that we did discuss the possible development of language and how it might apply to a situation like this, and the language that resulted is a consultation mechanism.

I think it would be hard to argue that a consultation mechanism should result in a change in that order.

Senator MCCLURE. I think it is safe to assume from what you just said that if your view prevails within the administration, the implementing legislation that may at some future date be written will not contravene that principle.

Ambassador YEUTTER. I would say that is a fair statement.

Senator MCCLURE. But you do not control all of that process either, because the Ways and Means Committee and the Finance Committee may disagree.

Mr. Roh, you are shaking your head. They do not have that kind of hold on the administration process of submitting legislation.

Ambassador YEUTTER. They do not, Senator McClure, because although we intend to consult fully with them, ultimately this has to be an administration product that will be submitted.

Senator MCCLURE. I understand that, and I do not mean to cause you problems with that.

If I could turn just very briefly to 161(v) of the Atomic Energy Act, the uranium provision.

Now, as I understand it, the administration does not like that provision in todays's world.

Ambassador YEUTTER. I am not sure that one could characterize the view that way, but since this is administered by Secretary Herrington, let me ask Mr. Martin if he would like to comment.

Mr. MARTIN. I do not think it matters whether we like it or not. It is certainly the law.

Senator MCCLURE. Well, it is the law, but you are trying to change it.

Mr. MARTIN. With respect to Canada.

Senator MCCLURE. Yes, with respect to Canada, which is one of the two major potential suppliers unless we are really looking to the Soviet Union, which I do not think we have yet decided to do.

Ambassador YEUTTER. Basically the change, Senator McClure, does not really reflect dissatisfaction with that provision. It reflects, rather, the view that in a free trade arrangement negotiation we ought to have free trade wherever we can.

Senator MCCLURE. Now, there is a national security provision in this Free Trade Agreement as there is in existing law; is that correct?

Ambassador YEUTTER. Yes. It is a narrower exemption in this agreement than it would be in present law.

Senator McClure. Can you tell me from the negotiations with the Canadians on this subject if the Canadians were prepared to remove their restriction on the purchase of Canadian uranium for national defense purposes?

Mr. Reinstein. They would be allowed an exception on restricting exports there under Article 907(c).

Senator McClure. If they desire, they may continue that restriction that is imposed by their law and policy?

Mr. Reinstein. Where it is militarily related and has to do in this case with preventing the spread of nuclear weapons. They do not want to see Canadian uranium used anywhere for military uses.

Senator McClure. I understand that. Whether I agree with it or not, I understand their position.

Is that policy consistent with the stated purpose of this agreement?

Mr. Reinstein. I think yes, it is.

Senator McClure. It is free trade except where they do not want it?

Mr. Reinstein. Well, I think everyone recognizes that national security is a very special area, and it has been recognized in the GATT and elsewhere.

Senator McClure. But national security is not really the reason why they have that prohibition, is it?

Ambassador Yeutter. I am not sure why they have the prohibition.

Senator McClure. It is nonproliferation, is it not?

Mr. Reinstein. I would guess, and I am not familiar with the history of that prohibition, that they do not want to encourage the spread of nuclear weapons and they would not like to see their uranium contribute to the spread of nuclear weapons.

Senator McClure. That is not directly related to the security of Canada as a nation.

Mr. Reinstein. I could see where they would find their national security threatened by the general spread of nuclear weapons.

Senator McClure. You know you can engage in circumlocution to get to any point on the globe you wish.

Ambassador Yeutter. Whatever the rationale, Senator McClure, it is encompassed in the national security portion of the agreement in the same language——

Senator McClure. I would assume that they are also prepared, if we desire to do so, to invoke the national security exception to protect our uranium industry in this country if we desire?

Ambassador Yeutter. I am not so sure they are prepared to go that far except to the degree that that is permissible.

Senator McClure. They only want it on one side but not on the other.

Ambassador Yeutter. The same language applies to both countries, of course.

Mr. Reinstein. We have preserved the right to also have restrictions for the same reasons.

Ambassador Yeutter. If we desire to do it, we can?

Mr. REINSTEIN. If, in fact, we can show that it is related to that, yes. If it is related to our national security, military defense, we have reserved the right to restrict trade on that basis.

Ambassador YEUTTER. If I recall correctly, and I do not have them in front of me right now, Senator McClure, I think we have four specific provisions in the national security area that are applicable to both countries.

Senator McCLURE. Yes, I have read them.

We have said that under this agreement they cannot charge us more for their natural gas than they could charge their own consumers; is that correct?

Now, that is kind of a general statement but it is not precise because you have to look at where that charge is applied and where between producer and consumer you measure.

Ambassador YEUTTER. Correct.

Senator McCLURE. But the measurement is to be the same on both sides?

Mr. REINSTEIN. They may not require a higher price for exports than for comparable domestic sales. That is the commitment, right.

Senator McCLURE. Can they charge lower prices?

Mr. REINSTEIN. For export sales? There is nothing in the agreement that prevents them from doing that. They may have their own reasons for wanting to prevent——

Senator McCLURE. If they decide to charge lower, does that give them a competitive advantage over producers in this country?

Ambassador YEUTTER. Yes, but that will subject them—I am sorry, Bob, to interrupt.

If they do that, they will obviously be subjected either to the potential of a countervailing duty suit or an antidumping suit. Those would be our protections against——

Senator McCLURE. Then if I read you correctly that if at anytime they began to undersell their own domestic market, we would view that as a violation of this agreement even though it does not specifically say they cannot do it?

Ambassador YEUTTER. Well, it might not necessarily be a violation of the agreement, and I doubt that it would be, Senator McClure, but it certainly would be reviewable by our industry, which could file these cases if it so desired.

In other words, if our industry felt that those low Canadian prices were in violation of U.S. countervailing duty law or U.S. antidumping law, the affected domestic industry here could file cases. It would be more likely that the industry would do this than that the government would.

We, the government, could do so as well, but, generally speaking, these countervailing duty cases and antidumping cases are filed by the industry. In other words, we could self-initiate cases. Our Commerce Department could self-initiate cases.

Senator McCLURE. We could or the industry could.

Ambassador YEUTTER. Yes.

Senator McCLURE. The existing provisions of law in that regard would remain unchanged?

Ambassador YEUTTER. That is correct.

Senator McCLURE. Does the agreement reduce the restrictions on U.S. investment in the Canadian uranium mining industry?

Mr. REINSTEIN. The agreement does not. Canada has, in fact, reduced those restrictions on December 23, 1987. They announced a policy where they had restricted the foreign ownership of producing uranium properties to one-third. They raised that to 49 percent last December. They did that for everybody, not just for the United States.

Under the agreement, that new regime represents the floor on investment restrictions.

Senator McCLURE. So they are not free to change it back?

Mr. REINSTEIN. They are not free to go back to a one-third restriction.

Senator McCLURE. But they are free to maintain——

Mr. REINSTEIN. Yes. Having liberalized it, that liberalization gets folded in and we start from there rather than from the old limit.

Senator McCLURE. But they are free to maintain the existing limit?

Mr. REINSTEIN. They are free to maintain that limit. As we mentioned earlier, we did not get agreement to eliminate the restrictions on investment in Canada.

Ambassador YEUTTER. But there is nothing, Senator McClure, that precludes us from going back after additional liberalization in that or any other area in the future.

Senator McCLURE. Sure. I understand that.

I have a number of questions that I will submit for the record. One area which I would invite your particular attention to is the way in which this agreement will affect the existing intertie access policy of Bonneville Power Administration, but I will not take the time to go into that at this time.

Any further comments you want to make, or would you just seek blessed relief?

Ambassador YEUTTER. I think we have covered the issue very thoroughly, Senator McClure. It has actually been a pleasure.

Senator McCLURE. All right.

The record will remain open until Friday for Senators to submit questions and for you thereafter to respond in writing to those questions.

Ambassador YEUTTER. Certainly.

Senator McCLURE. Thank you very much. The committee is recessed.

[Whereupon, at 5:40 p.m. the hearing recessed, to reconvene Thursday, April 21, 1988.]

UNITED STATES-CANADA FREE TRADE AGREEMENT

THURSDAY, APRIL 21, 1988

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 2 p.m. in room SD-366, Dirksen Senate Office Building, Hon. J. Bennett Johnston, chairman, presiding.

OPENING STATEMENT OF HON. J. BENNETT JOHNSTON, U.S. SENATOR FROM LOUISIANA

The CHAIRMAN. This hearing will come to order.

The committee meets today to consider the United States-Canada free trade agreement. On Tuesday we had a very interesting and I believe enlightening hearing with the U.S. Trade Representative and the Department of Energy on the administration's interpretation of the agreement as it pertains to energy and natural resources.

I would have to say that I was more than a little surprised, however, to learn that there had been little analysis on the impact of the agreement on the energy and natural resource industries prior to the agreement being negotiated.

Today's witnesses will shed a little more light on the potential impact of the agreement on the natural gas and electricity industries, and I look forward to hearing their interpretation of the agreement.

Before we begin, I do want to lay one matter to rest. Many of today's witnesses are concerned about the fate of FERC Order 256 under the free trade agreement. In response to my questions and letters on the fate of Order 256, both the Canadian Ambassador and the United States Trade Representative have given unequivocal assurances that Order 256 is not affected by the agreement.

You may rest assured that the legislative history on the effect and intent of the agreement will be very clear on this subject.

So let us begin then with our first panel, which will be: Robert C. Thomas, president of Tenneco Gas & Pipeline Co.; William T. McCormick, chairman and CEO of CMS Energy Corp.; Nick Bush, president of Natural Gas Supply Association; and Ken Wonstolen, executive director and general counsel of Independent Petroleum Association of the Mountain States.

Gentlemen, welcome to the Committee. Your statements will be put into the record as if read in full, and we would prefer that you summarize and tell us the guts of the way you feel about this Agreement. But if you cannot do that and want to read your statement, well, do not read too long. [Laughter.]

Mr. Thomas, please proceed.

STATEMENT OF ROBERT C. THOMAS, PRESIDENT, TENNECO GAS AND PIPELINE GROUP, ON BEHALF OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Mr. **Thomas**. Thank you, Mr. Chairman.

My name is Robert C. Thomas and I am president of Tenneco Gas Pipeline Group, and I am here today on behalf of the Interstate Natural Gas Association of America. And I will summarize my comments.

INGAA supports the principle of free and open trade, so we therefore endorse the United States-Canadian Free Trade Agreement, which once it is in effect will govern energy trade between our two countries. My comments, of course, are directed to chapter 9 of the agreement, which addresses the energy area, and specifically I will speak to how the agreement affects our natural gas trade with Canada.

Since at least 1972, Canadian natural gas exports have averaged 4 to 5 percent of United States gas needs. So therefore, Canadian exports of natural gas, while important, are not a dominant aspect of the natural gas industry in the United States.

In addition to the principle of free and open trade, we support the agreement for three specific reasons:

First, the agreement anchors the developing trend on both sides of the border to allow the economics of the marketplace to govern energy trade between the two countries;

Second, the agreement provides a measure of long term security for energy users, including natural gas consumers;

And third, the agreement does not disturb the current or future production incentives of either country.

As an example of the benefit of market forces, in 1979 the Canadian border price of natural gas was roughly $2.50 per million Btu's. One year later, the Canadian border price was roughly $4.50 per million Btu.

When the U.S. market experienced a surplus of deliverability in the early 1980's, the border price of Canadian gas lingered above the 1979 price levels until nearly 1985. While it took only 1 year for Canadian prices to increase $2 per million Btu in response to the gas shortage, it required nearly 4 years for Canadian prices to decline that same amount.

Canadian prices were slow to move downward because of the government price controls, which discriminated against U.S. consumers and which responded more to political than to economic pressures.

The agreement will protect against such political interference with the marketplace by prohibiting the two governments from imposing taxes, fees, or price wars on exports of natural gas, thereby lending a sense of permanence to the free gas trade which has recently developed between the two countries.

Now, those of us who endured the curtailment era of the 1970's in this country appreciate the need for secure long term gas supply, and we feel that Canadian reserves represent a significant potential for balancing future U.S. supplies of natural gas with the demand.

If the Canadian government ratifies the agreement, it will be making an important commitment to the free movement of natural gas by assuring us that Canada will erect no artificial barriers to future incremental demands the United States may have for natural gas. And this commitment is binding even if the Canadian gas supply should tighten.

We believe this increased assurance of a reliable, competitively priced supply would protect current markets and contribute to an expanded future U.S. market for gas. Even after approximately 6 years of a surplus of natural gas deliverability in the United States, end users are still reluctant to commit to natural gas as their fuel of choice because they still remember the curtailments of the 1970's.

As we all well know, the oil and gas business in this nation is currently depressed. But the Canadian imports did not cause the problem, and I believe that part of this may be a solution by helping to develop the long term markets for natural gas in this country.

The agreement will provide flexibility by not placing any restriction on either country's right to offer new incentives for gas expiration and development in order to maintain their reserve base. This ensures that the reliability of our domestic exploration and production industry need not be jeopardized by any overdependence on imported Canadian gas.

We are well aware that some of our domestic producers feel that, in spite of the provisions protecting each country's production incentives, the agreement is an additional threat to their businesses.

It is certainly possible that, if Canadian exports to the United States were to be restricted, there might be a short term improvement in domestic natural gas production. But the long term, the long term viability of our industry hinges on restoring buyer confidence in not only the availability of natural gas, but also its availability at competitive and not politically set prices.

We believe the potential of the long term benefits of the agreement outweigh any short term benefits of restricting imports.

So in conclusion, INGAA supports the United States-Canadian Free Trade Agreement because it solidifies confidence, which comes from trade governed by the economics of the marketplace, rather than by governmental decree; because it offers assurance that Canadian gas will be available as one option for meeting the long-term United States gas needs, and might thereby protect current markets and lead to an expanded gas market; and finally, because it leaves unfettered the right of either country to provide any production incentives necessary to maintain an adequate reserve base, whether now or in the future.

Mr. Chairman, that concludes my statement. I would be happy to answer any questions.

[The prepared statement of Mr. Thomas follows:]

STATEMENT OF

ROBERT C. THOMAS, PRESIDENT

TENNECO GAS PIPELINE GROUP

ON BEHALF OF THE

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

APRIL 21, 1988

Mr. Chairman and Members of the Subcommittee:

My name is Robert Thomas, and I am President of Tenneco Gas Pipeline Group, and I am here today on behalf of the Interstate Natural Gas Association of America (INGAA). INGAA is a non-profit national trade association representing virtually all of the major interstate natural gas transmission companies operating in the United States. Our companies move natural gas from the producing areas to end users or distributors who, in turn, deliver the gas to the ultimate consumer. INGAA member companies purchase or transport most of the natural gas imported into this country from Canada. Approximately 90 percent of the natural gas transported and sold annually in interstate commerce flows through the more than 200,000 miles of pipeline owned and operated by INGAA's member companies.

INGAA supports the principle of free and open trade. We therefore endorse the U.S.-Canadian Free Trade Agreement (Agreement), which, once in effect, will govern energy trade between our two countries. My comments are directed to Chapter Nine of the Agreement, which addresses the energy area. Specifically, I will speak to how the agreement affects our natural gas trade with Canada.

Today, the U.S. and Canada are the world's largest trading partners, exchanging $124 billion of goods in 1986. Natural gas plays an important role in the trade between the two countries. Over the last thirty years, volumes of natural gas flowing across the Canadian border have changed dramatically. But since at least 1972, Canadian natural gas exports have averaged 4 to 5 percent of U.S. gas needs. Thus, Canadian exports of natural gas are an important, though not dominant, aspect of the natural gas industry in the United States.

REASONS FOR SUPPORTING THE ENERGY CHAPTER OF THE AGREEMENT

We support the Agreement for three specific reasons. First, the Agreement anchors a developing trend on both sides of the border to allow the economics of the marketplace to govern the energy trade between the two countries. Second, the Agreement provides a measure of long-term security for energy users, including natural gas consumers. And third, the Agreement does not disturb the current or future production incentives of either country.

1. Market Forces

The Agreement permits the international marketplace to work to benefit consumers of natural gas in the United States. Just ten short years ago the gas industry looked quite different from the way it appears today. In 1979, the Canadian border price of natural gas was roughly $2.50 per MMBtu. One year later, the Canadian border price was roughly $4.50 per MMBtu. Canadian exporters found purchasers in the U.S. for their expensive gas because, as this committee well remembers, domestic interstate natural gas was in short supply.

Unfortunately, the rapid increase in Canadian prices during the period of U.S. shortages was not matched by an equally rapid price decrease when the U.S. market experienced a surplus of deliverability. In fact, the border price of Canadian gas lingered above 1979 price levels until nearly 1985. In other words, while it took only one year for Canadian prices to increase $2 per MMBtu in response to the gas shortage, it required nearly four years for Canadian prices to decline that same amount. Canadian prices were slow to move downward because of Canadian government price controls which discriminated against U.S. consumers, and which responded more to political than to economic pressures.

The Canadian government did gradually remove the price controls which were slowing the descent of Canadian border prices. As a result, Canadian gas export prices are competitive in the U.S. marketplace.

The Agreement will protect against such political interference with the marketplace by prohibiting the two governments from imposing taxes, fees, or price floors on exports of natural gas. Thus, the Agreement lends a sense of permanence to the free gas trade which has recently developed between the two countries.

2. Long-Term Security

Increased security of supply from Canada is one of the benefits to be derived from assuring that fair competitive forces rather than government decree govern the natural gas trade between our two countries. Those who lived through the curtailment era in this country appreciate the need for a secure, long-term gas supply.

Canadian reserves represent a significant potential for balancing U.S. supplies of natural gas with demand. If colder-than-normal winters befall us, if environmental concerns lead to increased gas demand, or if the overall demand for gas increases for any other reason, the public interest will be best served if a reliable, supplemental source of gas is available to U.S. consumers at competitive prices rather than at artificial prices set by governmental authorities. The Agreement provides for a reasonably reliable, supplemental gas source because it eliminates the planning uncertainty introduced by government-imposed price discrimination.

If the Canadian government ratifies the Agreement, it will be making an important commitment to the free movement of natural gas by assuring us that Canada will erect no artificial barriers to future incremental demands the United States may have for its gas. This commitment is binding even if Canadian supplies should tighten. In such a situation, the Agreement prevents any Canadian government trade measures which may be enacted from constraining trade below proportionate levels.

This increased assurance of a reliable, competitively-priced supply could contribute to an expanded U.S. market for gas. Even after approximately six years of a surplus of natural gas deliverability in the U.S., end users are still reluctant to commit to natural gas as their fuel of choice because they still remember the curtailments of the mid-1970s. As we well know, the oil and gas business in this nation is currently depressed, but the Canadian imports did not cause our problems. Indeed, I believe that assured access to Canadian supplies can help solve our problems.

3. Restrictions Not Placed on Production Incentives

The third reason for our support of the Agreement is that it neither disturbs important production incentives nor curbs the right of Congress to enact any new production incentives which are deemed necessary. This country has recognized the need to provide producers with incentives to explore for oil and gas. An important example is the Natural Gas Policy Act (NGPA) of 1978. The NGPA succeeded in providing natural gas producers the price incentives necessary to increase exploration and production, and relieved the gas shortages of the 1970s.

The Agreement does not place any restrictions on either country's right to offer new incentives for gas exploration and development in order to maintain their reserve bases. This ensures that the reliability of our domestic exploration and production industry need not be jeopardized by over-dependence on imported Canadian gas.

I am well aware that domestic producers feel that in spite of the provision protecting each country's production incentives, the Agreement is an additional threat to their businesses. Clearly, if Canadian exports to the U.S. were to be restricted, there might be a short-term improvement in domestic natural gas production. But as I stated earlier, the long-term viability of our industry hinges on restoring buyer confidence in not only the availability of natural gas but also its availability at competitive, not politically set, prices. I believe the potential long-term benefits of the Agreement outweigh any short-term benefits of restricting imports, especially since the right to enact any domestic production incentives is preserved.

CONCLUSION

INGAA supports the U.S.-Canadian Free Trade Agreement because it solidifies the confidence which comes from trade governed by the economics of the marketplace rather than by governmental decree. We support the Agreement because it offers assurance that Canadian gas will be available as one option for meeting long-term U.S. gas needs, and may thereby lead to an expanded gas market. And, finally, INGAA supports the Agreement because it leaves unfettered the right of either country to provide any production incentives necessary to maintain an adequate reserve base, now or in the future.

The CHAIRMAN. Thank you, Mr. Thomas.
Mr. McCormick.

STATEMENT OF WILLIAM T. McCORMICK, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF CMS ENERGY CORP., ON BEHALF OF THE AMERICAN GAS ASSOCIATION

Mr. McCORMICK. Thank you, Mr. Chairman.

My name is Bill McCormick. I am chairman and chief executive officer of CMS Energy Corp., and its principal subsidiary, Consumers Power Co. We are the largest utility in the State of Michigan, serving 6 million of the 9 million people in the State. We also are major suppliers to the automobile, steel, chemical, paper, and other industries.

Today I am representing the American Gas Association, which has 300 gas distribution and transmission company members. In this connection, I am also Chairman of the American Gas Association's Gas Supply Committee, and I have been cochairman of the Joint AGA-Canadian Gas Association Task Force on Free Trade.

AGA strongly supports the Canada-United States Free Trade Agreement because we believe it will enhance the vital role that the natural gas industry can play in meeting the nation's energy security, economic, and environmental goals.

This is because in the past interference by government agencies and regulators in both Canada and the United States have resulted in an uncertain and risky trade environment for natural gas.

The Free Trade Agreement can assure that long-term reliable supplies of natural gas will not be hampered or disrupted by retroactive regulation. Furthermore, a secure, uninterrupted supply of natural gas has important implications for other U.S. policies.

We believe there are several important benefits to the free trade agreement: First and foremost is national security. Increasing U.S. natural gas use in our gas trade with Canada will reduce U.S. dependence on oil from the politically unstable Middle East.

Natural gas should replace 350,000 barrels of imported oil per day immediately—that is, with existing pipeline capacity—and 720,000 barrels of oil per day within 1 year.

Over the next 5 years, additional gas supplies could displace 1.7 million barrels per day of imported oil.

The second important benefit is balance of payments. Aside from the national security benefits of oil displacement, increased gas use would improve our balance of trade. Oil at the border——

The CHAIRMAN. With Canadian gas?

Mr. McCORMICK. Canadian gas will improve our balance of trade, yes. This is because it would displace foreign oil, which at the border is 50 percent more expensive than imported Canadian gas. If gas displaces oil——

The CHAIRMAN. Well, why would they—you have got about 40 percent of the load now which is dual fuel capable. You are not saying that, with the passage of this agreement, that that would switch from oil to gas, are you?

Mr. McCORMICK. Yes, Mr. Chairman, that is exactly what I am saying.

The **Chairman**. This agreement would make the price of gas come down?

Mr. **McCormick**. No, it would make the volume of gas more available in certain parts of the country where oil is being burned where gas could be burned.

The **Chairman**. How does it make gas more available?

Mr. **McCormick**. Well, it provides a competitive source of gas. Gas from Canada right now only represents 4 percent of the consumption in this country.

The **Chairman**. What is keeping it out now?

Mr. **McCormick**. I think a lot of what is keeping it out is the uncertainty of the contractual relationships between Canada and the United States. For example, there are very few, if any, long-term contracts between Canadian suppliers and United States users, simply because of the uncertainty that exists in the regulatory and political environment between the two countries.

As gas displaces oil at the rate set out above, the U.S. would reduce its trade deficit by more than $200 million per month immediately and up to $1 billion per month within 5 years.

A third important reason that we support the Free Trade Agreement is enhancing U.S. gas supply security. A recent DOE study, "Energy Security, A Report to the President," maintains that natural gas is the most substitutable fuel for oil, and that the United States has plentiful long-term gas supplies.

Natural gas trade with Canada will allow United States markets to build on a combined resource base of 250 trillion cubic feet of proven reserves and more than 1,000 trillion cubic feet of proven and potential resources.

By our estimates, in the year 1990 natural gas will be some 50 percent greater than lower 48 State oil produced. So our point here is that increased gas demand and availability is the exploration incentive producers need, and the entire nation will benefit.

Fourth is the economic benefits of the free trade agreement to energy users. More secure energy supplies will mean lower energy prices over time. These benefits could translate into U.S. products that are more competitive in world markets.

This is particularly true for highly efficient gas-fueled industrial cogenerators and combined cycle powerplants. An increase in the sources of supply, including Canada, will mean more competition, which in turn will bring lower long-term prices to important energy users that must compete in world markets.

The fifth important reason relates to environmental and efficiency advantages of natural gas. Because it is such a clean-burning fossil fuel, using natural gas has definite environmental benefits.

It emits fewer pollutants than other fossil fuels and lowers the cost of environmental compliance for U.S. industry. Naturally, these lower compliance costs translate into financial savings for U.S. industries that are facing stiff foreign competition.

At the same time, an environmental deadline, such as the nonattainment provisions of the Clean Air Act, would otherwise increase industry's pollution control costs.

So in conclusion, Mr. Chairman, I firmly believe that the energy sections of the free trade agreement will benefit consumers, producers, industry, both gas and electric customers, as well as distributors and pipelines in both the United States and Canada.

I would urge the Congress to consider the long-term benefits to our Nation of an enactment of the Free Trade agreement. Thank you very much.

[The prepared statement of Mr. McCormick follows:]

STATEMENT OF
WILLIAM T. McCORMICK, JR.
ON BEHALF OF THE AMERICAN GAS ASSOCIATION
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
OF THE UNITED STATES SENATE
ON THE
CANADA - U.S. FREE TRADE AGREEMENT
April 21, 1988

STATEMENT OF INTEREST

I am William McCormick, Chairman and CEO of CMS Energy Corporation, the parent company of Consumers Power Co. My company provides natural gas and/or electricity to nearly six million of the State of Michigan's nine million residents. As a sponsor of the Midland Cogeneration Venture, a planned, highly efficient combined cycle power plant in Midland, Michigan, we are very interested in long-term energy trade with Canada. In fact, we have already tapped the Canadian market for some long-term natural gas supplies to fuel this 1,370 megawatt (MW) facility, although much of the supply commitments will come from domestic gas producers.

Today, however, I am appearing on behalf of the American Gas Association (A.G.A.). A.G.A. is a national trade association with some 250 natural gas distribution and transmission company members. These companies serve 84.3% of the gas utility customers in the U.S. and have a long standing interest in natural gas supply security.

In this regard, I was Co-chairman of the A.G.A./Canadian Gas Association Joint Task Force on Long-Term U.S.- Canadian Natural Gas Trade. This Task Force began meeting in the autumn of 1986, to develop some common policies on long-term natural gas trade, which they could recommend to the people and the governments of their two countries. In September 1987, the Task Force published its report, Long-Term U.S/Canadian Natural Gas Trade, which specifically endorsed a bilateral treaty dealing with natural gas trade between our two countries. The Task Force report said:

> Representatives of the natural gas industry on both sides of the border recognize their own primary responsibilities for the development of gas supplies and for the working out of financial and operational arrangements for production and delivery of gas. They recognize also that their efforts will be ineffective without the support of governments in both countries, as expressed formally in a bilateral energy trade treaty.
> Such a treaty could be negotiated separately or could be embodied in a broader Canada-U.S. trade treaty, such as proposed in the current free trade negotiations between the two countries. The important thing is that an agreement on natural gas trade should be concluded as quickly as possible -- ideally within the next 12 months.[1/]

Therefore, I am here today to support the U.S./Canadian Free Trade Agreement not only as the Chairman and CEO of a diversified energy business and as a U.S. energy distributor, but also on behalf of the broad interests of A.G.A.'s national membership and the international membership of the U.S./Canadian Joint Task Force. I firmly believe that the energy sections of the Free Trade Agreement will benefit consumers, producers, industry and electrical customers, as well as natural gas distributors and pipelines in both countries.

STATEMENT OF POSITION

The American Gas Association supports the Canada - U.S. Free Trade Agreement. North America is rich in natural gas resources that can provide long-term, secure energy service to citizens in both the U.S. and Canada. Before the citizens of one country can rely on the energy resources of another, however, there must be assurances that trade will not be hampered or disrupted by retroactive regulation and/or legislation on the part of either government. The Free Trade Agreement includes these assurances.

Managers of industrial plants, electric utilities, and other large energy-intensive facilities need assurances that the dollars they invest in gas-fired equipment today won't turn into a bad investment in the future. The "supply insurance" that the Free Trade Agreement includes will help these investors turn to natural gas. Their fuel choice, in turn, has implications for other U.S. policies:

FIRST, increasing U.S. natural gas use and our gas trade with Canada will reduce U.S. dependence on oil from the politically unstable Middle East. Natural gas could replace 350,000 barrels of imported oil per day immediately and 720,000 barrels per day within one year. Over five years, gas could displace 1.7 million barrels per day.

SECOND, aside from the national security benefits of oil displacement, increased gas use would improve our balance of trade. Oil at the border is 50 percent more expensive than natural gas. If gas displaced oil at the rates set-out above, the U.S. would reduce its trade deficit by more than $200 million per month immediately, and up to $1 billion per month within five years.

THIRD, additional and secure energy supplies from Canada will mean lower energy prices over time for individual users and businesses. These benefits can translate into U.S. products that are more competitive in world markets. This is particularly true for highly efficient gas-fueled industrial cogenerators and combined cycle power plants.

FOURTH, because it is such a clean-burning fossil fuel, using natural gas has definite environmental benefits. Natural gas not only emits fewer pollutants than other fossil fuels, it also lowers the costs of environmental compliance for U.S. industry. In addition, using natural gas as a primary vehicular fuel or as a fuel additive is being seriously considered as one way to solve serious ozone and carbon monoxide problems in several major U.S. cities.

Despite the many benefits of increasing across-the-border natural gas trade, some natural gas producers (both U.S. and Canadian) fear the Free Trade Agreement. Both groups point to "subsidies" supposedly enjoyed by their competitors. Although A.G.A. is studying the subsidy questions, it does not appear that Canadian government programs will have a significant effect in the U.S. market. For example, the Canadian Exploration Development Incentive Program is a temporary incentive program for small producers, very limited in nature, that expires on December 31, 1989. We also note that the way to "balance" Canadian incentives, if any do remain, is to provide equal incentives to U.S. producers. In any event, disincentives such as the Windfall Profit Tax should be repealed as soon as possible, as apparently agreed to by House and Senate Conferees on the Omnibus Trade Bill now in Conference.

In 1987, only about five percent of the gas used in the U.S. was imported from Canada. A.G.A. expects this percentage to increase but only gradually, not exceeding 10 percent even by the year 2010. The real effects of the Free Trade Agreement will be to increase customer confidence in natural gas resources; to stimulate natural gas demand (with many national security, economic, and environmental benefits); and to facilitate the development of Canadian and Alaskan gas projects for future supplies.

THE FTA HAS DEFINITE NATIONAL SECURITY BENEFITS

The Free Trade Agreement greatly benefits U.S. national security. First, it protects natural gas imports from sudden disruptions or politically motivated price increases. Second, it allows the U.S. to rely on some Canadian gas to displace less secure oil imports from the unstable Middle East.

On the first point, the FTA protects U.S./Canadian energy imports from the threat of sudden cut-offs. More specifically, Article 904 requires that if Canada restricts natural gas imports to the U.S., it has to similarly restrict its domestic gas consumption. Naturally, the U.S. is similarly bound. Although Article 904 does not apply "in times of war or other emergency in international relations"[2/] it provides substantial supply security, in contrast to Middle East oil suppliers who have in the past attempted to influence U.S. policy by threatening to cut-off oil supplies in order to gain their political ends.

On the second point, the U.S. has a clear policy of displacing imported oil with natural gas. For example, the U.S. Department of Energy's report to the President, Energy Security, stressed the importance of substituting natural gas for imported oil.[3/] The conclusions in this report were also echoed by the National Defense Council Foundation (NDCF), which published an issue alert, Will the Future Be Reflected In the Past? -- The DOE Energy Security Report One Year Later.[4/] NDCF makes strong national security arguments that the U.S. should reduce its reliance on imported oil, in part, by displacing Middle East oil with North American natural gas.

A.G.A. has estimated that nationwide, natural gas could displace 350,000 barrels of oil a day immediately.[5/] After that, we estimate that gas could displace 720,000 barrels a day within one year, and 1,700,000 barrels a day within five years. The following is a concrete example of how natural gas can displace oil in just one section of the U.S. -- the Northeastern states.

OIL DISPLACEMENT EXAMPLE:

> In 1986, electric utilities in the Northeast used 380 thousand barrels/day of oil -- roughly 56 percent of all the U.S. oil consumed by U.S. electric power plants and seven percent of total U.S. net oil imports. If these plants were converted to natural gas, they would require an additional 814 billion cubic feet (Bcf) of gas per year to be delivered to the Northeast. Because the present infrastructure needs to be expanded dramatically to serve this load, the U.S. Federal Energy Regulatory Commission is even now considering some 31 different projects to serve the Northeast. It is significant that these projects would draw their gas from both domestic and Canadian sources.

Increased natural gas use surely has overriding national policy benefits. In 1987, imported oil made up about 40 percent of the nation's oil consumption. To the extent that U.S. consumers can switch to natural gas (whether from our own production or from a secure trading partner like Canada) we enhance our national security, improve our economic health/balance of payments, and even create a cleaner environment for ourselves (discussed below).

ENHANCING
U.S. GAS SUPPLY
SECURITY

North American natural gas supplies are both secure and abundant. Because oil resources are being depleted at a much quicker rate than natural gas, the hydrocarbon resource base is becoming increasingly gas prone. The Potential Gas Committee has estimated that, with currently foreseeable technology and economics, there are 620 trillion cubic feet (Tcf) of potential conventional resources in the lower-48 states alone, with an additional 118.8 Tcf of gas resources in Alaska. When 159 Tcf of proved reserves are added to this number, the lower-48 states has the equivalent of about 50 years of conventional supply at 1986 production levels.[6/] Canada has proved reserves of 97 Tcf and a total of 426 Tcf of potential and proved reserves.[7/] The combined resources of the U.S. and Canada -- an extraordinary 256 Tcf of proved reserves and 940 Tcf of proved and potential reserves -- are more than adequate to supply traditional and new markets, especially high-efficiency energy technologies that can lower the cost of U.S. goods and services.

THE ECONOMIC BENEFITS OF THE FREE TRADE AGREEMENT

Providing additional, reliable supplies of natural gas from Canada can also lower the cost of natural gas to U.S. energy users -- both individuals and businesses. These lower costs can aid in making U.S. products more competitive in world markets (by lowering energy costs over time), using natural gas has other balance-of-trade benefits. Imported oil is 50 percent more expensive than natural gas at the border. Oil displacement of the magnitudes discussed earlier, would reduce the U.S. trade deficit by more than

$200 million per month immediately, and up to $1 billion per month within five years. These trade benefits should not be overlooked.

THE ENVIRONMENTAL BENEFITS OF INCREASING NATURAL GAS USAGE

Natural gas is an environmentally attractive fuel, whose use can reduce ozone and carbon monoxide pollution. Compared to other fossil fuels, natural gas emits far fewer pollutants, including carbon monoxide, nitrogen oxide, sulfur dioxide, and hydrocarbons, as well as ash, sludge, and solid waste. These pollutants can be reduced quickly since many existing emitters already have gas service and can convert easily. Using natural gas often has lower capital and operating costs too, so that the cost of reducing air pollution can be lower. Naturally, these lower compliance costs translate into financial savings for U.S. industries that are facing stiff foreign competition, at the same time that environmental deadlines, such as the nonattainment provisions of the Clean Air Act, would otherwise increase an industry's pollution control costs.

We could give numerous examples of ways to use natural gas to reduce pollutants.

1. A combined cycle gas power plant uses a gas-fueled turbine, a steam turbine and a heat recovery steam generator to generate electricity. Such units emit less than 0.3 percent of the sulfur dioxide and 57 percent of the nitrogen dioxide of comparable coal fired units, nor do they produce ash or sludge. They can be built quickly (in one to two years vs. eight to fifteen for coal or nuclear units) and are extremely cost effective. The relatively low

capital cost of combined cycle units is approximately $500 per kilowatt, about 1/3 the cost of new coal units.

2. Gas-fired cogeneration systems that generate electricity and steam to run industrial processes have similar environmental, energy and cost efficiencies.

3. "Select use" of natural gas allows a plant operator to get immediate emission reductions by using natural gas with coal, in the same or even in different units. The operator's pollution control costs can be much less than installing a "scrubber" or other conventional pollution control device.

4. Besides reducing oil imports, using natural gas as a primary vehicular fuel, or as a fuel additive can reduce carbon monoxide emissions by as much as 99 percent, nitrogen oxides by 65 percent, and reactive hydrocarbons by 85 percent. Reductions of this magnitude could be the key to clean air in cities where air pollution has been an intractable problem up to now.

Before regulators and plant operators commit themselves to these options, however, they need to be assured that there will be adequate natural gas supplies in the future. Although the U.S. resources base is large enough to sustain this growth, the Free Trade Agreement provides an important extra level of supply security.

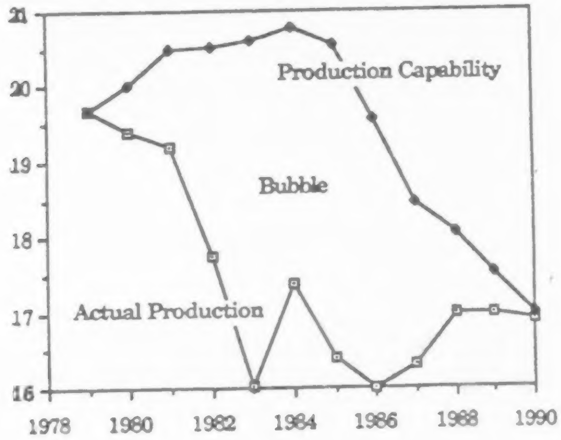
BENEFITS FOR DOMESTIC GAS PRODUCTION

Some U.S. producers perceive Canadian gas imports as a competitive threat, which could disadvantage them. For several reasons, however, they have little to fear and much to gain from the Agreement.

First, they have little to fear because the Free Trade Agreement will have no effect on current gas trade between the U.S. and Canada or on current drilling in the U.S. The

Figure 1

Production and Production Capability: 1979-1990



U.S. presently has a surplus of natural gas and it is the existence of these excess inventories -- not Canadian gas -- that has depressed the rate of gas exploration and production in the U.S. Excess U.S. natural gas deliverability (generally known as the gas "bubble") was 2.2. Tcf in 1987.[8/] In calendar year 1988, however, A.G.A. projects that the bubble will shrink to 1.1 Tcf and that it will be essentially zero by 1990 (full year estimate). Please see Figure 1.

Two factors are causing the bubble to shrink: (1) reduced drilling (the result of low energy prices and the gas "bubble"); and (2) increased gas demand (the result of lower gas prices and increased market share). By 1989, the "bubble" will have shrunk enough to spur drilling in the U.S. Thus, U.S. drilling will pick-up despite continued Canadian imports and, in fact, A.G.A. has even factored in a gradual increase in Canadian imports of one Tcf in 1988 and 1.4 Tcf by 1990. Yet, our analyses still show that excess supplies are gone after 1990, creating market-driven incentives for new drilling in the U.S.

Second, allegations have been made on both sides of the border that producers in the other nation have an advantage in competing for gas sales in U.S. markets. The focal point of these complaints by U.S. producers are programs such as the Canadian Exploration Development Incentive Program. In this program the Canadian government provides a federal cash grant of 33 percent of exploration and development expenditures up to a corporate limit of $10 million of eligible expenses/year. Because the benefit itself is taxable income, the typical benefit to a major drilling company is well below the $3 million level. As evidence of this, the Canadian government estimates that only about $300 million was granted in 1987. Some industry estimators believe that this overstates the amounts paid out. Even so, this program is scheduled to be reduced by half on October 1, 1988 and to disappear entirely by December 31, 1989.

Other factors which may favor one producer over another are taxes, both federal and local, and royalty holidays. Comparison of these programs in Canada and the U.S. is extremely difficult. A.G.A. has undertaken such a comparison, based on survey data, and with peer review. We plan to have the results available in mid-May.

Lastly, A.G.A. firmly believes that establishing a North American natural gas trade will rebuild customer confidence and allow gas to serve promising new markets for gas-fired cogeneration and combined cycle power plants. The price induced shortages of the late 1970s and the volatility of all energy prices since then, including gas prices, has eroded consumers' confidence in the U.S. gas resource base. The fear that natural gas was a "scarce" resource, embodied for example by the prohibitions on gas usage in the Fuel Use Act, continued even into the 1980s. It was not until last year that Congress finally repealed the Fuel Use Act and customers could buy gas for new industrial facilities and power plants without administrative impediments.

Although this legacy will be hard to overcome, one way to rebuild consumer confidence is to point to the enormous gas resource base of both the U.S. and Canada -- a combined 256 Tcf of proved reserves and 940 Tcf of potential and proved resources. Once the FTA is in place, with its assurances that Canadian supplies will not be withdrawn from the marketplace (except under the most extraordinary circumstances) and that prices will be market based, consumers will be able to make investment decisions based on total North American resources. While U.S. resources are large, the combination of U.S. and Canadian resources provides an extraordinary degree of supply security and with it price stability. These are the kind of assurances that investors in new gas-fired industrial and power plant projects need before making large capital commitments. Time and again, gas marketers have told us that it is difficult, if not impossible, to penetrate the market for new gas-fired cogeneration and combined cycle power plants unless the customer believes that gas resources are plentiful and that supplies will not suddenly be withdrawn from their markets for political reasons.

Increased consumer confidence can translate directly into an overall increase in demand for both U.S. and Canadian producers. In no way will U.S. producers lose out to Canadian producers under the Free Trade Agreement. Rather, both countries will benefit from increased confidence in supply security, and both countries' producers will share in increased demand for natural gas. Of this market, we expect the lion's share to go to U.S. producers, predicting that domestic production would serve 90% of a 21.7 Tcf market by the year 2010.[9] Thus, while the Free Trade Agreement will have little effect on current gas trade, its real effect will be to build investor confidence and new gas markets in the future.

THE EFFECT OF U.S. NATURAL GAS REGULATIONS ON "FAIR" TRADE

There are also allegations that in order to have "fair" natural gas trade with Canada, a litany of discrete orders and opinions at the U.S. Federal Energy Regulatory Commission (which governs pipeline ratemaking) and the Economic Regulatory Administration (which authorizes energy imports and exports) have to be, variously, adopted into law in the case of FERC Opinion No. 256, eliminated in the case of FERC Order No. 500, or revised in the case of normal ratemaking procedures. We do not think that a treaty is the place to enact an entire regulatory agenda. Further, the alleged "unfairness" is either unrelated to the Free Trade Agreement and/or totally unsubstantiated.

For example, there are complaints that FERC Order No. 500 gives Canadian gas a marketing advantage over U.S. gas. Not so -- Order No. 500 requires all producers, both U.S. and Canadian, to offer take-or-pay credits when they avail themselves of open access transportation on a U.S. pipeline. Thus, producers in both countries are treated the same.

U.S. producers have opposed Order No. 500 crediting since its inception, and have in fact opposed any take-or-pay relief from FERC at all, but that has nothing to do with Canadian gas, fair trade, or the Free Trade Agreement. It has to do with proper U.S. rate and regulatory policies that stem from a lawful decision of our federal courts. Although U.S. producers may attack Order No. 500, it is important to keep in mind that:

> As a matter of U.S. law, this program is a direct result of a decision by the U.S. Court of Appeals, which required the Commission to address the take-or-pay contract issue, A.G.D. v. FERC, 824 F.2d 981 (D.C. Cir. 1987); and
>
> As a matter of policy, Order No. 500 actually helps make the pipeline neutral about whether to transport Canadian or U.S. gas. Before Order No. 500, pipelines incurred substantial take-or-pay liability by transporting domestic gas because most U.S. producers have not renegotiated their take-or-pay contracts. In contrast, they did not necessarily incur similar liabilities by transporting Canadian gas because Canadian producers have already renegotiated their take-or-pay contracts.

This imbalance was somewhat redressed by Order No. 500. Because transportation automatically earns take-or-pay credits under Order No. 500, any disincentive to transport U.S. gas compared to Canadian gas is gone. Thus, allegations that Order No. 500 discriminates unfairly against U.S. producers could not be more wrong.

As a second example, U.S. producers have also complained about FERC Opinion No. 256, even though it was a clear "win" for them. This specific case involves complicated ratemaking issues about how production and transportation costs for gas purchased in Canada and resold by a pipeline in the U.S. should be billed to the U.S. customers. FERC allocated more of those costs to the Canadian gas, making it relatively more expensive on the ground that it did not want to discriminate against U.S. producers. Now, having won this particular case, some U.S. producers want to enact a particular rate design into law in conjunction the Free Trade Agreement.

They would also like legislation requiring ERA to put the same ratemaking conditions in FERC Opinion No. 256 in ERA's import authorizations. This would mean that a single federal case would affect rate designs for local distribution companies that buy Canadian gas directly. This is clearly going too far -- raising questions of federalism and the preemption of state regulatory authorities.

Finally, some producers want to use the FTA as an excuse to overturn other specific ERA and FERC decisions. These include an attempt to reverse ERA's decision that FERC regulates interstate transportation and that ERA should not try to put conditions on FERC Order No. 436. There are also complaints about ratemaking on the Northern Border Pipeline, a transporter of Canadian gas, even though many other pipelines (that transport only U.S. offshore gas) have similar financing arrangements and rate designs.

It seems clear that having failed to win before FERC, ERA, and/or the U.S. Courts, the complainants are using the Free Trade Agreement to achieve a failed regulatory agenda. The FTA is a treaty between two sovereign nations. It has outstanding national security, balance of energy-trade, and environmental benefits. Regulatory policy, however, raises separate and discrete issues that are inapplicable to such a trade agreement. Issues of state and federal ratemaking have traditionally been delegated to special regulatory bodies precisely because they are typically not amenable to legislation, and certainly not amenable to international treaty negotiations.

FOOTNOTES

1/ American Gas Association/Canadian Gas Association Joint Task Force, Long-Term U.S.-Canadian Natural Gas Trade, emphasis supplied, p. 4 (September 1987).

2/ Canada-United States Free Trade Agreement, Article 2003 (December 9, 1987).

3/ United States Department of Energy, Energy Security Report to the President, DOE/5-0057 (March 1987).

4/ National Defense Council Foundation, Will the Future Be Reflected in the Past? -- The DOE Energy Security Report One Year Later, Washington, D.C. (March 1988).

5/ American Gas Association, The Strategic Role of Natural Gas In Replacing Imported Oil, Arlington, Va. (May 22, 1987).

6/ A.G.A. Gas Supply Committee, The Gas Energy Supply Outlook Through 2010, Arlington, Va. (October 1985).

7/ Procter, R.M; Taylor, J.C. Wade, J.A.; Oil and Natural Gas Resources of Canada - 1983, Geological Survey of Canada, Paper 83-31; Department of Energy Mines, and Resources, 1984.

8/ American Gas Association, Natural Gas Production Capability - 1987-1990, Arlington, Va. (January 4, 1988).

9/ American Gas Association, TERA-Analysis 88-1, Arlington, Va. (January 15, 1988), at Table 3, p. iv.

The Chairman. Thank you, Mr. McCormick.

Mr. Bush.

STATEMENT OF NICHOLAS J. BUSH, PRESIDENT, NATURAL GAS SUPPLY ASSOCIATION

Mr. Bush. Mr. Chairman, I am Nicholas J. Bush, president of the Natural Gas Supply Association, a national organization comprised of independent and integrated domestic producing companies that market roughly 90 percent of the nation's natural gas production.

Mr. Chairman, we wholeheartedly endorse free and equal and open energy trade between the United States and Canada, and we do so for reasons that extend beyond a sincere commitment to principles of free trade and free markets. As Mr. Thomas indicated and I think we concur, domestic gas producers benefit when there is a flourishing market for their product.

Experience has shown that such a market results from strong consumer confidence, and it is immensely beneficial to all segments of the natural gas industry when end users are confident that the prospects for acquiring future supplies to meet reasonable demand expectations are good and that consumers will be able to compete for access to all competitively priced supplies that can serve their markets.

Most energy forecasts conclude that competitively priced imports of Canadian gas may make an important contribution to meeting future energy needs.

Thus, to the extent that the FTA reassures U.S. consumers that future natural gas supplies from Canadian will not be unnecessarily restricted or unreasonably priced, the agreement may contribute to more stable long-term United States gas demand and to a larger natural gas market than otherwise might exist absent such assurances, and domestic gas producers want to compete in a growing gas market.

I must say, though, initially to your reaction to Mr. McCormick's statement, I would say in the current environment, Senator, one thing that is true is that there are pipeline constraints, for instance from the Gulf Coast and the Southwest into the Northeast, particularly in the winter, and even into the Midwest.

And to the extent that Canadian gas expansion occurs in the current environment, I am not so sure yet that residual fuel oil backout will accrue well to all domestic producers to the degree that it could.

As well I might say that in the current environment as well, in winter certainly right now Canadian gas may not back out a lot of domestic gas. But the fact is as well that in the summertime, with demand levels down, Canadian gas does have a tendency when it increases in its import quantities to back out domestic gas.

But having said that, I would want to concur in general that the fact is that in the long term and in the interest of a stable and growing gas market, we concur that, yes, the free trade agreement, if it does contribute to consumer confidence for the reason I stated, it may even in fact increase domestic gas producers' positions.

Having said that, as you know, Mr. Chairman, we have, as many other associations representing producers have said, we do have some problems with the idea that necessarily when the free trade agreement is enacted we are going to be competing on an equal footing with our Canadian counterparts. I think that would be probably irresponsible of us, to leave you the impression that we believe that when the free trade agreement is enacted that we would automatically have an equal footing.

Of course, we still have price and non-price controls on at the wellhead in the United States. Canada has removed all of its controls at the wellhead. And in that sense, while we have been through that fight legislatively and I am not suggesting that we start it today again, I am saying that wellhead regulation, both price and non-price, does have an impact on domestic gas producers' abilities long term to supply all the available resource that is there in the United States.

And to say otherwise is just not right, and as a result we are going to have a capacity limitation at some point. We are going to lose resources otherwise that we would have, and thus we will not have the same advantage as our Canadian.

You have mentioned an important matter to us, Mr. Chairman, and I with you agree that Ambassador Gotlieb's letter of response to you we are taking at face value as it stated, and I was a little disturbed to hear a report of how the U.S. Trade Representative may have interpreted it.

I happen to believe that, as you did, that that represents a commitment by the Canadian government to say that they will not challenge Opinion 256 application to Canadian gas or actually to the U.S. regulatory system for interstate pipelines.

That is an incredibly important issue for domestic gas producers. It has been of an immense degree of importance to us. I am reassured by your commitment to saying that the legislative language will address that.

We have been advocating that type of attention. We appreciate it and we appreciate your reassurance today.

There is also another misunderstanding, Mr. Chairman——

The CHAIRMAN. First of all, let me make clear we were not talking about amending the treaty.

Mr. BUSH. No, I understand that.

The CHAIRMAN. But I think in the legislative history.

Mr. BUSH. Legislative history, I am sorry. I misspoke.

The CHAIRMAN. The Canadian Ambassador was in my office earlier, I guess it was late last week, and we discussed 256 and we said, it would be very important for you to get us an opinion that represents what your government says.

And of course, he knows that whatever he says is on behalf of the government. So that was not him speaking of his own opinion. He went back, checked it out, and was authorized to write that letter.

So we can count on that letter. It is a commitment of their government.

Mr. BUSH. We deeply appreciate your help in getting that as well.

Canadian imports, while they are only 5 percent of the United States, they are very significant in the California market, and in particular somewhere in the Pacific Northwest as well. They represent as much as 30 percent or 40 percent of that market at times. That is where their supply is, of their imports.

And I think at that time, you know, that makes a difference.

There is another issue that I wanted to raise of FERC that was misunderstood, and I just read today, and I am sorry I had not read it earlier, but Chandler Van Orman, the Deputy Administrator of VRA, had replied to this committee's request, Senator Nickels' request, about Order 500. And that reply is disappointing and I think misleading.

And the reason we have raised Order 500 as a potential problem between Canadian domestic producers—and it will be if it is enacted as the FERC says that it will be—has nothing to do necessarily with the construction of Mr. Van Orman's reply, which says that it hinges on whether or not you solve your take or pay problem.

The fact is that domestic producers have got to apply for—in shipping in the future, under Order 500 they have to be willing to offer up credits, and those credits apply whether or not you have solved your take or pay obligation. The problem is that most Canadian producers do not have a relationship historically with U.S. pipelines.

The United States pipelines historically have bought from the interstate pipelines of Canada. So that there is no crediting that is going to apply for Canadian production that is being shipped here under open access transportation. There is no crediting.

Who do the U.S. pipelines credit? And they missed that point or they have misstated the point, because in the Van Orman reply to Senator Nickles they have transposed Canadian suppliers with domestic producers, and it is not the same thing.

Canadian suppliers for the most part have been the interstate pipelines, not the Canadian producers. I just wanted to make that point because it is still—to us, the impact of Order 500 cannot be just set aside. It is going to be a future marketing deficiency if the FERC persists in this matter, and particularly with respect to our Canadian counterparts.

We have raised a number of other issues in our testimony, Mr. Chairman, and I will not go into them. Some of them are, as Senator Bentsen told me earlier, carrying coals to Newcastle, and I think in this case it might be the same thing.

We would suggest repealing the windfall profit tax, and we point out some of the differences between the tax implementation in Canada versus domestic.

The CHAIRMAN. I hope you are writing the President and calling him and urging him.

Mr. BUSH. The House debate is fast and furious right now. I was watching.

We are always urging repeal of windfall profit tax, and we will and we are as well.

The CHAIRMAN. And override the veto if it comes.

Mr. BUSH. Mr. Chairman, I think it is time to exit this testimony.

[The prepared statement of Mr. Bush follows:]

SUMMARY OF TESTIMONY
OF THE
NATURAL GAS SUPPLY ASSOCIATION

- NGSA strongly supports free, equal and open energy trade between the United States and Canada.
- The natural gas industry benefits when there is a flourishing market for natural gas. A strong market results from consumer confidence in the adequacy of future supplies readily available at reasonable, competitive prices.
- Competitively priced Canadian natural gas imports may make an important contribution to meeting future U.S. energy needs.
- While domestic natural gas producers are willing to compete with their Canadian counterparts for U.S. markets, adoption of the Free Trade Agreement will not necessarily provide an equal footing for such competition.
- Wellhead controls hobble the ability of domestic natural gas producers to compete with their Canadian counterparts. Total wellhead deregulation of natural gas will result in the development of additional domestic reserves, a lessening of the trade deficit, and enhancement of domestic producers' ability to compete with imports.
- Without an unconditional, genuinely open-access interstate natural gas pipeline transportation system domestic producers may be at a disadvantage in competing with Canadian gas. In particular, the contract abrogation provisions of FERC Order No. 500 create a problem.
- FERC Opinion No. 256 which requires uniform treatment for imported and domestic gas costs encourages fair competition and should be protected by Congress.
- U.S. tax policies which discourage domestic energy development should be repealed. The Windfall Profits Tax on oil is a measure long overdue for abolition.
- In order to encourage the beneficial elements of free and open trade, U.S. energy policy must be more responsive and more conducive to domestic energy development.

THE U.S.-CANADA FREE TRADE AGREEMENT:
THE U.S. GAS PRODUCERS' PERSPECTIVE

TESTIMONY
OF
NICHOLAS J. BUSH
PRESIDENT
NATURAL GAS SUPPLY ASSOCIATION

BEFORE THE
COMMITTEE ON ENERGY & NATURAL RESOURCES
UNITED STATES SENATE

APRIL 21, 1988

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. I AM NICHOLAS J. BUSH, PRESIDENT OF THE NATURAL GAS SUPPLY ASSOCIATION -- A NATIONAL ORGANIZATION COMPRISED OF INDEPENDENT AND INTEGRATED DOMESTIC PRODUCING COMPANIES WHICH MARKET ROUGHLY 90 PERCENT OF THE NATION'S NATURAL GAS PRODUCTION.

MR. CHAIRMAN, WE APPRECIATE THIS OPPORTUNITY TO COMMENT ON THE PENDING U.S.-CANADA FREE TRADE AGREEMENT (F-T-A) AND, IN PARTICULAR, ON ITS POTENTIAL IMPACT UPON DOMESTIC GAS PRODUCERS AND U.S. GAS MARKETS.

THE FREE TRADE AGREEMENT'S STATED ENERGY GOAL IS TO "ASSURE THE FREEST POSSIBLE BILATERAL TRADE IN ENERGY, INCLUDING NONDISCRIMINATORY ACCESS FOR THE U.S. TO CANADIAN ENERGY SUPPLIES AND SECURE MARKET ACCESS FOR CANADIAN ENERGY EXPORTS TO THE U.S."

THE NATURAL GAS SUPPLY ASSOCIATION (N-G-S-A) WHOLEHEARTEDLY ENDORSES FREE, EQUAL AND OPEN ENERGY TRADE BETWEEN THE UNITED STATES AND CANADA. AND WE DO SO FOR REASONS WHICH EXTEND BEYOND A SINCERE COMMITMENT TO THE PRINCIPLES OF FREE MARKETS AND FREE

TRADE. DOMESTIC GAS PRODUCERS BENEFIT WHEN THERE IS A FLOURISHING MARKET FOR THEIR PRODUCT. EXPERIENCE HAS SHOWN THAT SUCH A MARKET RESULTS FROM STRONG CONSUMER CONFIDENCE. IT IS IMMENSELY BENEFICIAL TO ALL SEGMENTS OF THE NATURAL GAS INDUSTRY WHEN END-USERS ARE CONFIDENT THAT THE PROSPECTS FOR ACQUIRING FUTURE SUPPLIES TO MEET REASONABLE DEMAND EXPECTATIONS ARE GOOD AND THAT CONSUMERS WILL BE ABLE TO COMPETE FOR ACCESS TO ALL COMPETITIVELY PRICED SUPPLIES THAT CAN SERVE THEIR MARKETS.

MOST ENERGY FORECASTS CONCLUDE THAT COMPETITIVELY PRICED IMPORTS OF CANADIAN NATURAL GAS MAY MAKE AN IMPORTANT CONTRIBUTION TO MEETING FUTURE U.S. ENERGY NEEDS. THUS, TO THE EXTENT THAT THE F-T-A REASSURES U.S. CONSUMERS THAT FUTURE NATURAL GAS SUPPLIES FROM CANADA WILL NOT BE UNFAIRLY RESTRICTED OR UNREASONABLY PRICED, THE AGREEMENT MAY CONTRIBUTE TO MORE STABLE LONG-TERM U.S. GAS DEMAND AND TO A LARGER NATURAL GAS MARKET THAN WOULD OTHERWISE EXIST, ABSENT SUCH ASSURANCES. AND DOMESTIC GAS PRODUCERS WANT TO COMPETE IN A GROWING GAS MARKET.

MEMBERS OF THE COMMITTEE ARE AWARE, HOWEVER, THAT NGSA AND OTHER PRODUCER ASSOCIATIONS HAVE EXPRESSED CONCERNS ABOUT THE ABILITY OF DOMESTIC GAS PRODUCERS TO FREELY COMPETE WITH THEIR CANADIAN COUNTERPARTS. SOME CANADIANS SAY THESE CONCERNS WITH BEING ABLE TO COMPETE "FAIRLY" OR -- TO USE THE CLICHE -- "ON A LEVEL PLAYING FIELD" ARE ACTUALLY THE WOLF OF PROTECTIONISM TRYING TO DRESS ITSELF IN THE INNOCUOUS COVER OF SHEEP'S CLOTHING. NOTHING COULD BE FURTHER FROM THE TRUTH.

THE WILLINGNESS OF DOMESTIC PRODUCERS TO COMPETE WITH OUR CANADIAN COUNTERPARTS FOR U.S. MARKETS IS SINCERE. BUT IT WOULD BE IRRESPONSIBLE TO LEAVE THIS COMMITTEE OR THE CONGRESS WITH THE IMPRESSION THAT WHEN THE FREE TRADE AGREEMENT IS ADOPTED, U.S. PRODUCERS WILL NECESSARILY BE ABLE TO COMPETE ON AN EQUAL FOOTING WITH THEIR CANADIAN COUNTERPARTS. EQUAL FOOTING DEPENDS ON WHETHER THE U.S. GOVERNMENT IS WILLING TO TAKE SPECIFIC ACTIONS THAT WOULD ALLOW DOMESTIC PRODUCERS TO TAKE ADVANTAGE OF NEW EXPLORATION, PRODUCTION AND MARKETING OPPORTUNITIES.

•

U.S OIL AND GAS DEVELOPMENT, AND AS A RESULT DOMESTIC PRODUCERS, ARE STILL RESTRICTED BY SEVERAL IMPORTANT GOVERNMENT POLICIES WHICH MUST BE CHANGED IF THE NATION IS TO BENEFIT FROM ITS REMAINING SIGNIFICANT ENERGY RESOURCE POTENTIAL.

CANADA HAS RESPONDED TO CHANGING ENERGY MARKET REALITIES MORE COMPLETELY THAN HAS THE U.S. NATURAL GAS IS TOTALLY DEREGULATED AT THE WELLHEAD IN CANADA, WHILE CERTAIN PRICE AND NON-PRICE CONTROLS ARE STILL IN EFFECT ON NATURAL GAS AT THE WELLHEAD IN THE UNITED STATES.

STATEMENTS SOMETIMES ARE MADE THAT THE CURRENT HIGHLY COMPETITIVE U.S. WELLHEAD MARKET FOR NATURAL GAS HAS MADE TOTAL DEREGULATION LESS IMPORTANT. WE DO NOT AGREE. TOTAL WELLHEAD DEREGULATION OF NATURAL GAS WILL RESULT IN THE EVENTUAL DEVELOPMENT OF SIGNIFICANTLY MORE DOMESTIC RESERVES, REDUCTION IN THE USE OF IMPORTED OIL, AND A LESSENING OF THE TRADE DEFICIT. TOTAL DEREGULATION OF NATURAL GAS AT THE WELLHEAD WOULD ENHANCE DOMESTIC PRODUCERS' LONG-TERM ABILITY TO COMPETE WITH CANADIANS.

AS IMPORTANT, THERE ARE SEVERAL ISSUES BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION WHICH MAY DETERMINE THE COMPETITIVENESS OF DOMESTIC GAS PRODUCERS. THE COMMISSION IS CURRENTLY CONSIDERING A FINAL RULEMAKING ON OPEN-ACCESS TRANSPORTATION OF NATURAL GAS ON INTERSTATE PIPELINES. ACHIEVING A NON-DISCRIMINATORY, OPEN-ACCESS NATIONAL TRANSPORTATION SYSTEM IS VERY IMPORTANT FOR NATURAL GAS PRODUCERS AND CONSUMERS AND NGSA HAS STRONGLY SUPPORTED FERC'S EFFORTS IN THIS REGARD.

THE COMMISSION'S INTERIM TRANSPORTATION RULE, ORDER NO. 500, HOWEVER, CONTAINS AN EXTREMELY DAMAGING REQUIREMENT CALLED CROSS-CONTRACT CREDITING WHICH, IF INCORPORATED IN THE FINAL RULE, WILL HAVE A NEGATIVE IMPACT ON DOMESTIC GAS DEVELOPMENT AND WILL PLACE DOMESTIC PRODUCERS AT A DISADVANTAGE IN COMPETING WITH CANADIAN GAS TO WHICH THE CONTRACT ABROGATION PROVISIONS OF ORDER NO. 500 WILL NOT APPLY.

APPENDED TO MY TESTIMONY, MR. CHAIRMAN, ARE NGSA'S MOST RECENT SUBMISSIONS TO THE COMMISSION ON ORDER NO. 500. I WOULD RESPECTFULLY ASK THE COMMITTEE TO REVIEW THE PROBLEMS CROSS-

CONTRACT CREDITING WILL MEAN TO DOMESTIC PRODUCERS. AS MEMBERS OF THE COMMITTEE MUST KNOW THERE IS CONSIDERABLE CONTROVERSY IN THE NATURAL GAS INDUSTRY OVER THE RECOVERY OF SIGNIFICANT CONTRACT REFORMATION COSTS -- USUALLY REFERRED TO AS THE PASSTHROUGH OF BUY-DOWN AND BUY-OUT COSTS FOR TAKE-OR-PAY LIABILITIES.

THE FEDERAL ENERGY REGULATORY COMMISSION, AS A GENERAL RULE, IS NOT ALLOWING THE RECOVERY OF TAKE-OR-PAY SETTLEMENT COSTS IN PIPELINE DEMAND CHARGES. BUT TAKE-OR-PAY SETTLEMENT COSTS ASSOCIATED WITH CANADIAN CONTRACTS HAVE BEEN PERMITTED BY FERC TO BE PLACED IN PIPELINE DEMAND CHARGES. IN AN ENVIRONMENT IN WHICH NATURAL GAS SALES ARE WON AND LOST BECAUSE OF A FEW PENNIES DIFFERENCE, THIS INCONSISTENT POLICY IS NOT UNIMPORTANT. IF DOMESTIC GAS IS TO BE FULLY COMPETITIVE, A POLICY THAT TREATS SETTLEMENT COSTS EQUALLY IS NEEDED.

THE COMMITTEE MAY BE FAMILIAR WITH FREQUENT REFERENCES BY THE DOMESTIC PRODUCING INDUSTRY TO THE IMPORTANCE OF FERC'S OPINION NO. 256. SIMPLY STATED, OPINION NO. 256 DECREED THAT

U.S. INTERSTATE PIPELINES COULD NO LONGER PASSTHROUGH CERTAIN COSTS OF CANADIAN GAS IN THE DEMAND CHARGE OF THEIR RATE STRUCTURE FOR WHICH SIMILAR COSTS OF U.S. GAS WERE NOT ALLOWED TO BE PASSED-THROUGH IN THE SAME MANNER. OPINION NO. 256 IS VERY SIGNIFICANT TO DOMESTIC PRODUCERS WHO TRY TO COMPETE AGAINST CANADIAN GAS, PARTICULARLY IN THE CRITICAL CALIFORNIA MARKET. FOR YEARS, DOMESTIC PRODUCERS IN THE SOUTHWEST WHO SERVE THE EL PASO AND THE TRANSWESTERN PIPELINE SYSTEMS INTO CALIFORNIA, AS WELL AS CALIFORNIA PRODUCERS SERVING THEIR OWN MARKETS, HAVE COMPETED AGAINST CANADIAN GAS WHICH, BY TAKING ADVANTAGE OF UNEQUAL RATE STRUCTURE TREATMENT, HAD SIGNIFICANT PRICE ADVANTAGES.

THE FREE TRADE AGREEMENT WILL NOT REVERSE OPINION NO. 256, BUT THE FTA WILL PERMIT CANADA TO CHALLENGE THE OPINION UNDER THE BINATIONAL CONSULTATION AND DISPUTE RESOLUTION PROCEDURE. WE WOULD ASSUME THAT THE CANADIAN GOVERNMENT MAY DO SO -- GIVEN ITS STRONG OBJECTION TO THE OPINION AND ITS APPARENT WILLINGNESS TO FIGHT FOR THE INTERESTS OF ITS PRODUCERS AND GAS PRODUCTION. THE FEDERAL ENERGY REGULATORY COMMISSION HAS NOT YET IMPLEMENTED

OPINION NO. 256 ON IMPORTED GAS. MOREOVER, IT APPEARS THAT THE BINATIONAL DISPUTE RESOLUTION PROCEDURE ASSUMES THAT A PANEL WILL BE CONVENED OF PARTIES FROM BOTH NATIONS TO REVIEW THE ISSUE UNDER DISPUTE AND CONCEIVABLY THE PANEL WOULD HAVE THE POWER TO OVERRIDE THE DECISION OF EITHER COUNTRY'S REGULATORY AUTHORITY.

GIVEN THE IMPORTANCE OF OPINION NO. 256, WE WOULD STRONGLY URGE THE CONGRESS TO MAKE IT CLEAR THAT OPINION NO. 256 MAY NOT BE OVERTURNED THROUGH THE DISPUTE RESOLUTION PROCESS. AS IMPORTANT, THE CONGRESS SHOULD WEIGH CAREFULLY THE IMPLICATIONS OF THIS EXTREMELY POWERFUL F-T-A RESOLUTION PROCEDURE THAT HAS NO PROVISION FOR REVIEW OF THE PANEL'S DECISIONS, PARTICULARLY WITH RESPECT TO ENERGY MATTERS.

THE ISSUES OF CANADIAN TAX POLICIES VERSUS U.S. TAX POLICIES AS THEY RELATE TO ENERGY PRODUCTION ARE SOMEWHAT CONTROVERSIAL. THE DEPARTMENT OF ENERGY IN ITS RECENT REPORT STATES THAT "CANADIAN AND U.S. TAX AND FISCAL SYSTEMS DIFFER IN SO MANY SIGNIFICANT RESPECTS THAT EXACT COMPARISON IS DIFFICULT AND POTENTIALLY MISLEADING." PERHAPS, BUT IT DOESN'T MAKE SENSE TO IGNORE THE RESULTS OF DETRIMENTAL U.S. TAX AND FISCAL POLICIES.

CANADA DOES NOT HAVE A "WINDFALL PROFITS" TAX ON OIL AND NEITHER SHOULD THE UNITED STATES. THE "WINDFALL PROFITS" TAX WHICH ADVERSELY IMPACTS THE EXPLORATION FOR OIL AND INDIRECTLY FOR GAS SHOULD BE REPEALED IN THIS SESSION OF CONGRESS.

THERE ARE, OF COURSE, OTHER TAX AND ROYALTY DIFFERENCES BETWEEN THE U.S. AND CANADA WITH RESPECT TO ENERGY. THERE IS A PROVISION IN CANADA THAT PERMITS ROYALTY "HOLIDAYS" FOR CERTAIN PRODUCTION FROM EXPLORATORY WELLS DRILLED BETWEEN OCTOBER, 1986 AND NOVEMBER, 1989 TO DEPTHS BELOW 8,000 FEET. THIS ENCOURAGES EXPLORATION FOR GAS IN CANADA. FURTHER, CANADA ALSO PROVIDES FOR FULL CURRENT TAX DEDUCTION FOR EXPLORATION COSTS. THE TOTAL ROYALTY AND TAX BURDEN ON U.S. ENERGY PRODUCTION IS SIGNIFICANT AND ITS IMPACT ON DOMESTIC PRODUCERS CAN BE SEVERE. AFTER THE TRADE AGREEMENT IS ENACTED, THE CONGRESS SHOULD REVIEW THE APPROPRIATE TAX AND RELATED LAWS WITH AN EYE TO ENCOURAGING DOMESTIC EXPLORATION AND DEVELOPMENT.

FINALLY, THE U.S.-CANADA FREE TRADE AGREEMENT DEBATE HIGHLIGHTS THE NECESSITY OF ADDRESSING U.S. POLICIES ON RESPONSIBLE ENERGY DEVELOPMENT ON ITS PUBLIC LANDS. THE U.S. PETROLEUM INDUSTRY HAS AN OUTSTANDING ENVIRONMENTAL RECORD. THE POTENTIALLY ENERGY RICH LANDS OF ANWR AND OFFSHORE CALIFORNIA SHOULD BE OPENED FOR RESPONSIBLE EXPLORATION AND DEVELOPMENT.

MR. CHAIRMAN, THE PENDING U.S.-CANADA FREE TRADE AGREEMENT, WHEN ADOPTED, IS LIKELY TO HAVE LITTLE IMMEDIATE IMPACT ON DOMESTIC GAS MARKETS. LONGER-TERM, THE IMPACT OF THE AGREEMENT IS LIKELY TO DEPEND UPON THE ACTUAL ENERGY POLICIES WHICH ARE ADOPTED BY THE RESPECTIVE NATIONS.

AFTER THE AGREEMENT IS ENACTED, IF U.S. GAS PRODUCTION REMAINS BURDENED WITH LEGISLATIVE AND REGULATORY DISINCENTIVES AND CONTROLS, THEN U.S. PRODUCERS WILL UNDOUBTEDLY LOSE MARKET SHARE AND THE DOMESTIC ECONOMY WILL SUFFER. THE WAY TO PREVENT THIS AND TO ASSURE THE BENEFICIAL ELEMENTS OF FREE AND OPEN TRADE IS TO MAKE U.S. ENERGY POLICY MORE RESPONSIVE AND MORE CONDUCIVE TO DOMESTIC ENERGY DEVELOPMENT.

THANK YOU FOR THIS OPPORTUNITY TO PRESENT THE VIEWS OF THE NATURAL GAS SUPPLY ASSOCIATION.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Regulation of Natural Gas)
Pipelines After Partial)
Wellhead Decontrol)

Docket Nos. RM87-34-000,
et al. (Order Nos. 500,
et seq.)

COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION

Pursuant to the Commission's Notice of Public Hearing issued in the above styled and docketed proceeding on March 8, 1988, the Natural Gas Supply Association ("NGSA") respectfully submits the following comments:

NGSA SUPPORTS THE PRO-COMPETITIVE EFFORTS OF THE COMMISSION AS EXPRESSED IN ORDER NO. 436

NGSA strongly supported the non-discriminatory carriage principles of Order No. 436, and continues to favor open-access transportation by interstate pipelines which, when coupled with other Commission initiatives, has provided a means whereby consumers can truly obtain supplies of natural gas at the lowest reasonable rate. The natural gas pipeline system provides the means whereby supplies of natural gas available in the producing areas can reach the consumer. Inasmuch as the pipelines provide the only feasible means of getting natural gas from the producer to the consumer, the Commission should, by its lawful regulation of the interstate natural gas pipeline industry, take the necessary steps to ensure that the pipelines which it regulates in fact provide non-discriminatory transportation to those who request it. Only through this means can the Commission assure that the consumer will receive the benefits of a competitively priced fuel.

THE COMMISSION SHOULD RECOGNIZE THE SUBSTANTIAL PROGRESS THAT HAS BEEN MADE IN RESOLVING TAKE-OR-PAY WITHOUT GOVERNMENT INTERFERENCE

The Commission should, in fashioning a final rule in these proceedings, recognize the substantial progress that has been made by pipelines and producers in resolving the take-or-pay liability of the pipelines. This progress has come about through the inexorable forces of the market at work. It has resulted in the resolution of 84% of pipelines' claimed outstanding liability through 1987 (see Appendix A). The cost of this resolution has been enormous to the producers. Pipelines, too, have borne costs in reforming these contracts, entered into solely for the purpose of standing ready to serve the actual and projected needs of their customers. LDCs, however, have borne little of these costs for lack of realistic cost passthrough. But to hear the pipelines and their customers tell the story, the producers should give up even more. They ignore the facts that the producers have spent billions of dollars to explore for and develop the very gas they said they needed. And these billions were invested by producers in the expectation that the pipelines and their customers would purchase the gas pursuant to the contracts the producers had with the pipelines. As the market determined that the prices were too high, the producers and the pipelines set about to find a satisfactory solution to the problem of high-priced gas. PRODUCERS GENERALLY GAVE UP THE BENEFITS OF THEIR CONTRACTS FOR NON-PRICE CONCESSIONS, AND A PRICE REDUCTION FOR FUTURE PRODUCTION THAT WOULD ALLOW THE PIPELINES TO CONTINUE AS A MERCHANT OF GAS. WHERE CASH PAYMENTS WERE MADE TO PRODUCERS, THE AMOUNT RECEIVED BY THE PRODUCERS HAS BEEN ONLY A FRACTION OF THE LIABILITY THAT THE PIPELINES OWED. These costs to producers are very real.

THE COMMISSION SHOULD DISAVOW BLANKET CREDITING AS A MEANS FOR "RESOLVING" THE TAKE-OR-PAY PROBLEM

Nowhere has the Commission done more harm to the producing industry in recent years than in its misguided attempt to resolve the pipelines' take-or-pay dilemma through the crediting mechanism propounded by Order Nos.

500, et seq. The Order No. 500 crediting mechanism is at odds with the principles of non-discriminatory open-access transportation. Crediting undermines the objectives of encouraging a freer, more competitive city gate market for natural gas. Crediting impedes open-access because it is a condition to access, a condition that many producers cannot economically afford to satisfy. In practice, many producers will not offer open-ended blanket credits to pipelines since they are unable to determine the economic effects such offers may have on their existing and future operations. Customers of pipeline companies with large outstanding take-or-pay obligations are being deprived of competitively-priced natural gas which could be transported and delivered to them if the Order No. 500 crediting mechanism were not in effect.

The Commission's Order No. 500 crediting mechanism has forced pipelines and producers that have freely negotiated resolution of their problems back into the adversarial ring once more. Those settlements, resolving as they did the pipelines' past take-or-pay liabilities and reforming as they did many of the contracts, often resulting in the release of gas for producers to sell on the open market in competition with pipelines, with other sellers of gas and with alternate fuels, have now been turned on their sides, with additional consideration now being demanded of producers in the form of take-or-pay credits when gas is moved on the very pipeline with which the producer thought it had reached settlement on fair and equitable terms. NGSA submits that the Commission should not by regulatory fiat permit this to occur. Yet this is the very result that blanket crediting has had. The Commission should provide in its final rule that any gas subject to take-or-pay relief or subject to a contract which has been renegotiated as a part of a settlement of pricing or take-or-pay disputes should be permanently exempt from crediting by the settling pipeline or any other pipeline transporter.

CREDITING, IF IT IS TO BE RETAINED AT ALL, SHOULD BE SELECTIVE IN A MANNER SIMILAR TO THAT PROVIDED BY THE COMMISSION IN ORDER NOS. 500-C & 500-D

The Commission set the stage for a more rational basis for crediting when it provided exemptions to the crediting mechanism in Order Nos. 500-C and 500-D. The Commission should retain those exemptions, make them permanent and establish a rule whereby crediting is the exception rather than the rule.

1. As NGSA said in its comments to Order No. 500-C, filed January 22, 1988, interstate pipelines should not be permitted to apply credits against any minimum take obligations contained in producer-pipeline contracts. These provisions are generally contained only in those

contracts where a minimal level of production is necessary to avoid loss of reserves through reservoir damage or drainage, or will result in the shut-in of oil production. In addition, these provisions protect the producer against potential forfeiture of leases for lack of production and allow the producer to achieve the economic return on which its investment decision was made. To allow a pipeline to avoid its minimum-take obligation through a credit against that obligation cannot be justified by any so-called short-term public interest benefit.

2. Natural gas purchased for processing plants should be permanently exempted from any form of crediting. All gas processed through the plant should be exempt from crediting, not only percentage of proceeds contracts. The Commission should recognize that there are numerous interest owners of gas behind processing plants that are very minor interest owners. At times, it is impossible to identify and obtain offers of credit from some of these owners. In those cases where a substantial majority of ownership can be identified and offers of credit obtained, the producer desiring to have its gas transported cannot, as a matter of economics, "guarantee" the transporting pipelines that they (the producer) will provide credits to the pipeline attributable to the gas production of others. To impose such a requirement

discourages the production of gas and recovery of liquids and the products made from those liquids needed by industries throughout the nation.

3. Take-or-pay credits should not be available to any pipeline not a permanently open-access transporter. Unless the pipeline has agreed to be a permanent open-access transporter in the form of receiving and accepting a blanket certificate for open-access transportation, it should not be entitled to take any credits for transportation of third-party gas. The very premise behind the Commission's use of the crediting mechanism is that pipelines who transport gas for others on an open-access basis will lose market share while still being committed to purchase gas from producers. This federally-imposed "Catch 22" would be avoided if the pipelines were in some manner relieved of their obligations to purchase from the producers. No such rationale exists for the pipeline who does not agree to become a permanent open-access transporter. If a pipeline elects to transport only under Section 311 of the NGPA, it can flip back and forth between transporting and not transporting, depending on the status of its take-or-pay obligations. Markets would be in a turmoil if this were allowed to happen.

4. Property assignment rules of Order No. 500 unnecessarily restrict the free and fair exchange of

property for bona fide business reasons. Producers are not prone to transfer properties simply to avoid crediting regulations. On the other hand, producers may be prohibited from farming out or in properties if to do so subjects the producer to the strictures of Order No. 500 credits. This will indubitably result in fewer exploration and/or development wells being drilled, with the consequent loss of reserves to the market. This will occur at a time when the market is in need of additional gas reserves. NGSA urges the Commission to remove the crediting requirements from property assignments, including farm-outs and farm-ins. The result the Commission seeks to achieve can be done with a requirement that the crediting requirement follow the assignment of a gas purchase contract in the case of a property transfer, and with a close watch on the assignment or farm-out to affiliated producers.

5. Pipelines should be required to give the producer binding, advance written notice of any intent to apply credits to a contract other than the one from which gas was released. While Order No. 500 sought to keep the pipeline releasing gas from taking credit under both the release and for transportation of that same gas, it does give the pipeline a choice of taking the credit pursuant to the terms of its contract with the producer or applying it to any other contract between the pipeline and the

producer. Producers are therefore left in a quandary as to which of its contracts will be subject to reduced economics and consequent potential penalty (e.g., through claims for additional royalty) if it causes its gas to be transported. The cross-crediting mechanism adopted by the Commission in its interim rules prevents appropriate gas contract administration by producers. It may be more than a year since deficiencies occurred that the producer is told by the pipeline, and solely at the pipeline's discretion, that there never was a deficiency. Contracts cannot be administered in any rational sense unless the pipeline is required to make a binding election and tell the producer about it before the fact.

6. The Commission should exempt gas from all new wells from crediting. The limited exemption of Order No. 500-C, tied as it is to "marker wells" and depth/spacing requirements, is far too restrictive. The already complex system created by the NGPA should not be burdened by another level of well classification. "New, new" Order No. 500 gas is simply too much. Gas produced from new wells should escape the credit requirement in all events. These new wells may not be drilled at all if they are subjected to the strictures of crediting. Alternatively, the Commission should exempt all new wells from crediting if drilled on acreage not subject to a contract with the transporting pipeline.

7. Finally, NGSA applauds the Commission's rate design initiative originally promulgated in Order No. 436. Unbundling of rates and assignment of costs to services actually performed according to the use of that service is commendable. However, too often the Commission has retreated from its pronouncements in Order No. 436 and has allowed rates for firm sales and transportation to bear a disproportionately small share of the pipelines' costs compared to the rates for interruptible transportation. NGSA submits that interruptible transportation should not be required to subsidize firm sales and transportation services. The Commission should carefully review rate proposals that come before it to ensure that each type of service provided by the pipeline bears only its own costs.

CONCLUSION

The Commission should re-evaluate the use of crediting as a means of solving the pipelines' alleged take-or-pay problems. NGSA submits that the crediting device, fraught as it is with serious infirmities as a means of providing sufficient quantities of natural gas to markets at the lowest reasonable rates, should be discarded altogether. It should be no more than a tool available to the Commission to ensure that, on a case-by-case basis, pipelines are treated fairly. It should not in any manner be available to extract further concessions from producers who have in fact settled their contract disputes with pipelines on terms mutually agreeable to the parties.

Respectfully submitted:

Nicholas J Bush

Nicholas J. Bush
President
Natural Gas Supply Association
1129 20th Street, N.W.
Suite 300
Washington, D.C. 20036

(202) 331-8900

APPENDIX A

A STATUS REPORT ON THE INTERSTATE PIPELINE TAKE-OR-PAY SITUATION:

TRENDS THROUGH 1987 WITH A PROJECTION FOR 1988

April 1988

NATURAL GAS SUPPLY ASSOCIATION
1129 20TH STREET, N.W.
SUITE 300
WASHINGTON, D.C. 20036

(202) 331-8900

EXECUTIVE SUMMARY

The Natural Gas Supply Association (NGSA) surveyed its members in March of 1988 to quantify outstanding take-or-pay obligations and the resolution of take-or-pay liabilities. The survey covered the period through year-end 1987, with estimates for 1988.

Major conclusions are as follows:

1. Producers have settled substantial amounts of take-or-pay claims -- a total of $14.5 billion through year-end 1987, or 84% of the cumulative total of $17.2 billion. Of the potential 1988 take-or-pay accumulation of $3.9 billion, producers have settled $3.1 billion, or 81%, of the total. These figures do not include any expected settlements subsequent to March 31, 1988.

2. The implementation of FERC Order 500 is not expected to have the desired effect of enhancing the resolution of take-or-pay accumulations. This is based on the finding that the take-or-pay resolution rates for 1987 (pre-Order 500) and 1988

(post-Order 500) are basically unchanged at 83% and 81%, respectively.

3. The survey results show continuing improvements in take-or-pay resolution rates when compared to previous NGSA surveys. The 1986 NGSA survey reported a 59% cumulative resolution rate versus 71% and 84% resolution rates for the 1987 and 1988 surveys, respectively. These changes reflect the ongoing nature of take-or-pay negotiations, and indicate that the take-or-pay situation is continuing to improve.

4. Take-or-pay exposure is concentrated in a few pipelines. Four interstate pipelines account for 54% of the oustanding take-or-pay liabilities through 1988, while accounting for only 24% of 1987 interstate pipeline field purchases. The top eight pipelines account for 80% of the oustanding liabilities, but only 46% of the pipeline gas purchases. A number of pipelines were found to have only minor or no take-or-pay liabilities.

5. In 1987, over 93% of the gas released by pipelines and sold to other parties was credited by producers against interstate pipeline take-or-pay

liabilities. Moreover, those pipelines generally having the highest take-or-pay liabilities had the highest percentage relief through released gas. This reveals the willingness of producers to include volumetric crediting as a resoluton mechanism independent of regulatory requirements such as FERC Order 500, and calls into question the need for such a rule.

6. Pipelines generally have not honored their take-or-pay obligations. Only 3.8% of outstanding take-or-pay obligations to producers have been paid by interstate pipelines through year-end 1987.

7. While the intrastate gas market accounted for 31% of the total gas market in 1987, intrastate pipeline take-or-pay liabilities amounted to only 7% of the total potential take-or-pay liability. This implicates the role of regulation in the interstate market as a major cause for take-or-pay accumulations, and suggests that the appropriate policy for reducing liabilities is to rely upon private negotiations.

The results indicate that the take-or-pay obligations of pipelines are being resolved through negotiations between producers and pipelines. Regulatory interference in the form of Order 500 is not expected to improve the efficiency or speed of resolution.

BACKGROUND

Producer-pipeline contracts for natural gas typically contain a contract quantity below which a pipeline is obligated to pay for the gas whether taken or not. Since the pipeline generally retains the right to take any underlifted volumes within a period of time specified by the contract with no additional payment, the take-or-pay obligations represent prepayments for gas. The cost to the pipeline is the interest cost on the prepayment. These provisions serve to allocate the risk of insufficient demand for the commodity. Producers bear the risk of lower takes down to the take-or-pay level; thereafter, pipelines bear the risk.

In recent years, pipelines have incurred take-or-pay liabilities due to insufficient demand for the gas they contracted to buy. They have argued for legislative or regulatory relief from take-or-pay provisions in their contracts, claiming that these provisions are a severe financial burden for them. In fact, producers have borne a large part of the downturn in demand, since they incur the financial liability down to the take-or-pay level.

Previous to Order 500, substantial pipeline take-or-pay liabilities had been resolved through voluntary producer-pipeline negotiations. In response to market forces, new and renegotiated contracts generally contain lower take-or-pay minimums, and increasingly provide for producers to refund prepayments if the pipeline is unable to take the gas within a specified time period. In order to assess the take-or-pay resolutions and outstanding liabilities, NGSA undertook a membership survey.

METHODOLOGY

The NGSA survey was undertaken in March of 1988 and represents the take-or-pay situation as of March 31, 1988. Twenty-two producers participated and are listed on Table 3. They represent 42% of the total 1987 dry gas production, and 80% of the 1987 interstate pipeline gas purchases from producers[1/]. In the previous NGSA survey conducted in the fall of 1987, the respondents covered 57% of the 1986 take-or-pay exposure reported by INGAA for the interstate pipelines. Because the set of

---

[1/] The 80% coverage overstates the actual proportion from the survey participants due to the fact that the sales figures include sales to pipeline marketing affiliates who have made the purchases on behalf of a party other than the affiliated pipeline.

respondents for both surveys is almost identical, the coverage should still be in the range of 50% to 60%.

Information was gathered from each participating producer on its take-or-pay status with each of the 23 interstate pipeline systems listed in Table 2, along with other interstate pipelines, intrastate pipelines, and direct sales customers. Data were collected on take-or-pay liabilities resolved, and deficiencies and payments through year end 1986, for the year 1987, along with an annual estimate for 1988. Unlike the 1987 survey, the current survey did not ask for an estimate of future take-or-pay settlements. Responses were collected and tabulated by an independent accounting firm in order to maintain confidentiality.

Although FERC Interim Order 500 went into effect on January 1, 1988, the current survey did not query producers as to the expected impact of Order 500 on 1988 take-or-pay liability and resolution.

In this survey, resolution refers to the value of take-or-pay obligations which have been resolved by producer/pipeline negotiations. Deficiencies represent the outstanding take-or-pay liability. Payments are the take-or-pay deficiencies actually paid to producers. Original liabilities refer to the sum of outstanding liabilities plus resolutions.

RESULTS

The table below summarizes the state of producer/pipeline take-or-pay resolution:

Resolution Of Interstate Pipeline Take-Or-Pay Liabilities

	Historical Through 1986	Actual Annual 1987	Projected Annual 1988	Cumulativ Total
Original Liability (Billion $)	11.81	5.34	3.85	21.00
Liability Resolved (Billion $)	10.01	4.45	3.11	17.57
Percent Of Original Liability Resolved (%)	85%	83%	81%	84%

As these survey results show, producers and pipelines have resolved a substantial amount of take-or-pay obligations. As of year-end 1987, nearly $14.5 billion of $17.2 billion in potential interstate pipeline take-or-pay liabilities incurred were resolved for a cumulative resolution level of 84%.

The implementation of Order No. 500 does not appear to have enhanced the take-or-pay settlement process. In 1987, 83% of all take-or-pay obligations were resolved through private producer/pipeline negotiations. A similar resolution rate is expected for 1988, and is consistent with the view that Order 500 will not have a significant impact on take-or-pay resolutions.

Given the complexity and inconvenience caused by the Order 500 cross-contract crediting provisions, as well as the progress of producer/pipeline contract renegotiation, regulatory intervention in the settlement process is not warranted.

The higher level of cumulative take-or-pay resolution reported in this survey (i.e., 84% versus 71% and 59% in the 1987 and 1986 surveys) demonstrates that the resolution of take-or-pay claims has increased over time. The negotiation process requires time to resolve all of the elements associated with pipeline/producer take-or-pay claims. Thus, the level of outstanding take-or-pay liabilities results partly from the inherent delays associated with renegotiating the complex contracts to equitably rebalance the interests of both producers and pipelines. It is not indicative of an intractable situation.

As shown in Table 1, four pipelines account for 54% of the outstanding take-or-pay deficiencies of interstate pipelines expected through the end of 1988. These four pipelines accounted for only 24% of 1987 interstate pipeline field purchases. The next four pipelines ranked by take-or-pay deficiencies account for only 26% of the total interstate pipeline deficiences while accounting for 22% of total 1987 pipeline gas purchases. Thus, eight pipelines account for 80% of the outstanding liabilities and only 46% of the pipeline gas purchases. Table 2 provides a listing of the pipelines included in each of the pipeline groups displayed in Table 1.

The current outstanding take-or-pay liability masks the true progress the industry has made in resolving past and future take-or-pay liabilities. The aggregate results hide the circumstances of individual pipelines. Table 2 shows the pipelines' current ranking according to outstanding take-or-pay liabilities, along with the 1986 and 1987 survey rankings and the percent of producer relief from potential take-or-pay liabilities. The relative ranking of companies has shifted dramatically since the 1986 survey. Several companies that experienced substantial take-or-pay problems have worked to reduce their exposure through voluntary negotiations with producers (both on a historical and prospective basis) and have fallen in the rankings. For example, Trunkline Gas, Southern Natural Gas, United Gas Pipeline, Transcontinental Gas Pipeline, and Columbia Gas Transmission have all fallen by four or more places in the rankings since 1986 survey. Conversely, other pipelines which did not have significant outstanding take-or-pay liabilities in the 1986 survey, have significantly increased their rank -- e.g., Texas Gas Transmission, ANR Pipeline, and El Paso Natural Gas. Consequently, the absence of a large reduction in the aggregate statistics does not imply that progress is not occurring. Rather, it is indicative of a situation in which pipelines with prior take-or-pay liabilities have significantly reduced their exposure, while pipelines with rather recent accumulations of take-or-pay liabilities have not yet been able to complete the process of renegotiating their contracts with gas producers.

As an additional segment of the survey, respondents were asked to report take-or-pay relief provided by producers through released gas. In 1987, 93% of the gas released and sold to non-pipeline parties provided volumetric relief of take-or-pay exposure. This effectively counters the notion that Order 436/500 has directly resulted in increasing take-or-pay liabilities due to the undermining of pipeline sales by gas transportation. The evidence indicates that, to the contrary, gas transportation is being effectively utilized in conjunction with contract abandonments to grant take-or-pay relief.

Since released gas is largely being credited for take-or-pay relief, Order 500 contract cross-crediting would not make any further significant contribution to take-or-pay resolution. Moreover, as Table 1 demonstrates, released gas is providing the most take-or-pay relief to those pipelines with the highest outstanding take-or-pay liabilities. For example, in 1987, 97% of the gas released by the top 4 pipelines and sold by producers provided take-or-pay relief. In contrast, only 32% of the gas released by the last 3 pipelines provided take-or-pay relief. Generally, the proportion of released gas providing relief diminishes as one goes down in the rankings. This trend demonstrates that take-or-pay relief is being provided through released gas to those pipelines with the greatest need.

The survey indicates that pipelines generally are ignoring their contractual obligations. Through 1987, interstate pipelines made prepayments of only $102 million out of the total outstanding take-or-pay liability of $3.3 billion -- a 3.8% payment rate. The pipelines' true cost of prepayments, however, is only the interest cost of the prepayment since they generally retain the right to take underlifted volumes within a specified future time period. Further, take-or-pay liability settlements via negotiation have ranged between 10¢-20¢ per $1 of liability. Pipelines' statements have significantly overstated the true financial impact of take-or-pay liabilities. Financial performance data reveal that through 1986, the average return on common equity by natural gas pipelines continued well above those of other industries.

By the end of 1987, intrastate pipelines had accumulated significant take-or-pay liabilities, amounting to $1.3 billion. While substantial, this amount is only 7 percent of the total potential take-or-pay liabilities, even though the 1987 intrastate market was 31 percent of the total gas market. The lower intrastate accumulations are a product of a less regulated environment. The much larger size of interstate pipeline take-or-pay liabilities resulted, in part, from a distorted outcome of previous wellhead price regulations which forced interstate pipelines to provide non-cash inducements, such as high minimum take levels, as a means of securing gas supplies. This historical experience is relevant when considering the final ruling on Order 500 cross-contract crediting because non-market solutions to the take-or-pay situation are likely to cause other unintended market dislocations.

CONCLUSIONS

Pipelines continue to advocate legislative or regulatory relief from take-or-pay obligations because they claim that these obligations have created a widespread threat to their financial integrity. However, the survey indicates:

1. the amount of producer take-or-pay relief has grown as the disposition of these liabilities are settled through private contract renegotiations;
2. that take-or-pay liabilities are concentrated among a few pipelines;
3. progress has been made in resolving the take-or-pay issue as companies with significant liabilities have renegotiated their contracts and fallen in the liability ranking; and
4. that over 93% of the gas released by pipelines is providing take-or-pay relief with the highest

> proportion of relief going to those pipelines with the largest outstanding take-or-pay liabilities.

Take-or-pay provisions in contracts between producers and pipelines serve to allocate the risk of a decline in market demand between contracting parties. Producers have been willing to settle take-or-pay liabilities for less than the full value. Consequently, they have already borne a disproportionate share of the downturn in the industry. They should not have to bear further risk through de facto abrogation of their contracts through FERC Order 500.

Take-or-pay liability accumulations are a symptom rather than a cause of a more fundamental issue -- the decline in gas consumption. Administratively interfering with or abrogating the private resolution process will not ameliorate the underlying cause, but instead threaten the development of future gas supplies as producers absorb a disproportionate amount of the risks that take-or-pay clauses were designed to disperse.

TABLE I

Take-Or-Pay Liabilities Through 1988 And Their Proportions Of The Interstate Market
(Pipelines Ranked By Outstanding Take-Or-Pay Deficiencies)

	Outstanding Take-Or-Pay Deficiencies (Million $)	Take-Or-Pay Resolution (Million $)	Total Potential Take-Or-Pay (Million $)
Top 4 Pipelines	1,857	3,496	5,353
Next 4 Pipelines	878	7,573	8,451
Next 4 Pipelines	361	3,652	4,013
Next 4 Pipelines	223	629	852
Next 4 Pipelines	35	1,841	1,876
Last 3 Pipelines	7	40	47
Other Interstate Pipelines	72	338	410
TOTAL	3,433	17,569	21,002

	Percent Of Total Outstanding Take-Or-Pay Deficiencies	1987 Market Share Of Interstate Pipeline Purchases	Percent Of Gas Volumes Released In 1987 Providing Take-or-Pay Relief
Top 4 Pipelines	54.1%	24.0%	97.3%
Next 4 Pipelines	25.6%	21.9%	96.4%
Next 4 Pipelines	10.5%	7.5%	85.5%
Next 4 Pipelines	6.5%	8.0%	84.6%
Next 4 Pipelines	1.0%	12.0%	74.8%
Last 3 Pipelines	0.2%	3.4%	32.4%
Other Interstate Pipelines	2.1%	23.2%	84.5%
TOTAL	100.0%	100.0%	93.4%

TABLE 2

Interstate Pipelines Included In Each Pipeline Group Shown On The Previous Table

(In Parentheses: the % of T-O-P Liabilities Resolved in the 1987 Survey)

March 1988 Survey

Top 4 Pipelines
1. Texas Gas Transmission Corp. (50%)
2. El Paso Natural Gas Co. (49%)
3. Tennessee Gas Pipeline (79%)
4. ANR Pipeline Co. (66%)

Next 4 Pipelines
5. Trunkline Gas Co. (91%)
6. Northern Natural Gas Co. (80%)
7. Natural Gas Pipeline Co. of America (84%)
8. Transco P/L & Gas Supply (94%)

Next 4 Pipelines
9. Southern Natural Gas Co. (95%)
10. United Gas Pipeline (93.6%)
11. Panhandle Eastern Pipeline Co. (73%)
12. Arkla, Inc. (72%)

Next 4 Pipelines
13. Sea Robin Pipe Line Co. (87%)
14. Northwest Pipeline Co. (21%)
15. Colorado Interstate Gas (59%)
16. Texas Eastern Transmission Corp. (45%)

Next 4 Pipelines
17. Williams Natural Gas Co. (89%)
18. Transwestern Pipeline Co. (83%)
19. Columbia Gas Transmission Corp. (99.6%)
20. Consolidated Gas Supply Corp. (14%)

Remaining 3 Pipelines
21. Florida Gas Transmission Co. (91%)
22. K.N. Energy (26%)
23. Williston Basin Interstate Pipeline (83%)

1987 Survey

Top 4 Pipelines
1. Tennessee Gas Pipeline (77%)
2. United Gas Pipe Line (60%)
3. Natural Gas Pipeline Co. of America (44%)
4. ANR Pipeline (22%)

Next 4 Pipelines
5. Northern Natural Gas (InterNorth) (54%)
6. El Paso Natural Gas (39%)
6. Southern Natural Gas (79%)
8. Texas Gas Transmission (50%)

Next 4 Pipelines
9. Transco P/L & Gas Supply (86%)
10. Trunkline Gas (92%)
11. Arkla (29%)
12. Sea Robin Pipe Line (52%)

Next 4 Pipelines
13. Panhandle Eastern Pipeline (48%)
14. Colorado Interstate Gas (48%)
15. Northwest Pipeline (10%)
16. Williams Natural Gas (81%)

Next 4 Pipelines
17. Transwestern Pipeline (55%)
18. Florida Gas Transmission (72%)
19. Columbia Gas Transmission (99%)
20. K. N. Energy (0%)

Last 2 Pipelines
21. Consolidated Gas Supply Corp. (0%)
22. Texas Eastern Transmission (99%)

1986 Survey

Top 4 Pipelines
1. Trunkline Gas
2. Southern Natural Gas
3. United Gas Pipe Line
4. Transcontinental P/L & Gas Supply Co.

Next 4 Pipelines
5. Northern Natural Gas (InterNorth)
6. Tennessee Gas Pipeline
7. Sea Robin Pipe Line
8. ANR Pipeline

Next 4 Pipelines
9. Arkla
10. Natural Gas Pipeline Co. of America
11. El Paso Natural Gas
12. Panhandle Eastern Pipeline

Next 4 Pipelines
13. Texas Gas Transmission
14. Columbia Gas Transmission
15. Northwest Pipeline
16. Transwestern Pipeline

Next 4 Pipelines
17. Colorado Interstate Gas Co.
18. Texas Eastern Transmission Corp.
19. Williams Natural Gas Co.
20. Florida Gas Transmission Co.

Last 2 Pipelines
21. K.N. Energy
22. Consolidated Gas Supply Corp.

TABLE 3

Natural Gas Producers Participating In The 1987 NGSA Take-Or-Pay Survey

1. Amoco Production Company
2. Anadarko Petroleum Company
3. ARCO Oil & Gas Company
4. Cabot Corporation - Oil & Gas Division
5. Chevron U.S.A., Inc.
6. Cities Service Oil & Gas Corporation
7. Conoco, Inc.
8. Exxon Company, U.S.A.
9. Hamilton Brothers
10. J. P. McHugh & Associates
11. Kerr-McGee Corporation
12. Marathon Oil Company
13. Maxus Exploration
14. Mobil Oil Company
15. Pennzoil Company
16. Shell Oil Company
17. Sun Exploration & Production Company
18. Tenneco Oil Exploration & Production
19. Texaco, Inc.
20. UNOCAL Corporation
21. Union Pacific Resources (formerly Champlin Petroleum)
22. Union Texas Petroleum

The **Chairman**. Thank you.

Next, Ken Wonstolen, the executive director of IPA of the Mountain States.

STATEMENT OF KENNETH A. WONSTOLEN, EXECUTIVE DIRECTOR AND GENERAL COUNSEL, INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES, ACCOMPANIED BY DAVID W. WILSON, PAST PRESIDENT, IPAMS

Mr. **Wonstolen**. Thank you, Mr. Chairman.

I am Ken Wonstolen, Executive Director of the Independent Petroleum Association of Mountain States. We are a regional trade association representing independent oil and gas producers in the Rocky Mountains.

I am accompanied today by David Wilson, my immediate past president, and Mr. Wilson will give you the background discussion on our testimony. And I would like to conclude with a set of specific policy recommendations for your consideration.

Mr. **Wilson**. Thank you.

We do represent the Rocky Mountain producers, where the gross value of oil and gas is off by about 40 percent over the last few years. Gas royalties in our largest states are off by 60 percent in the last few years, and this is certainly affecting not only the independent producers, but also the Federal Treasury, States, and Indian tribes.

If you would look at our part of the industry, we are becoming more and more gas-oriented than oil, and the comments today will relate totally to gas. We certainly do not blame all of our problems on Canadian gas and we are not calling for a limitation on natural gas imports.

Those of us in the industry who believe in free markets are having a difficult time, however, with some producers in overcoming a protectionist sentiment, particularly when we see the current inequities in Canadian imports that have been created by our United States Government.

We are, however, calling on many of the inequities that create this bias toward Canadian imports to be eliminated. Since these inequities were created by our Government, we believe they can be changed by our Government.

Just to mention a few of these equities, I would like to go through them. Many Canadian gas contracts go through the year 2000 and they contain take and pay contracts. If gas is not taken, it is still paid for, with no right to make up. Yet the FERC requires that domestic gas that has take or pay has to be made up in order to be passed, in order to be passed through.

Earlier, we have heard some talk about Opinion 256, and I would like to touch on that so-called as-billed decision for just a moment. This opinion we feel does help to level the playing field by requiring that imports conform to Opinion 256 rate treatment enjoyed by the domestic gas industry.

But yet, this opinion only applies where FERC has the authority, and that leaves in the current important status some large gaps outstanding.

The biggest gap is important transactions where FERC does not have authority, and this is primarily where you have direct purchases of imported gas by local distribution companies. The Economic Regulatory Administration, the ERA, does have authority over these transactions, but this far they have completely ignored Opinion 256 and declined to require that rate treatment in any import license authorized.

Also, another gap exists where FERC does have authority, but an importer has not yet had a rate case arise where they can apply prospectively the rate requirements under Opinion 256. We believe that the U.S. Government should close these existing gaps because prospective application of Opinion 256 will only reach a small portion of the gas that is currently being imported into the United States.

Let me give you an example of what this can mean to both producers and consumers when this is not done. If you look at the period from June 1985 to June 1986 in California, even though El Paso had a fully delivered, fully allocated cost price of $3.21 into California, Trans-Western's price was $3.40, where Pacific Interstate Transmission, moving typically Canadian gas, the price was $4.18.

The $4.18 gas was being sequenced before the domestic gas because of the rate treatment in the way costs were allocated to the demand and the commodity component. We question why consumers should bear these increased purchase costs while cheaper domestic gas remains available and why domestic producers should have to compete against that kind of rate treatment.

We believe that this and many other problems with Canadian gas occur because of affiliated relationships between the importers of Canadian gas. In normal commercial transactions, buyers typically naturally try to get the lowest possible price.

In imported gas contracts, the buyer on the contract does not always suffer the consequences of bad contracts entered into, since many consumers behind those buyers are typically held captive and pay the bill or else domestic producers pay the bills through reduced netback prices at the wellhead.

Importers are free to deal with affiliated companies to maximize overall corporate benefits, while shutting out competition from domestic gas and charging consumer prices resulting that are too high.

For example, in California, to mention once again since that is where roughly half of the imported gas into the United States goes, Pacific Gas & Electric buys gas from Alberta & Southern, a 100 percent owned affiliate in Canada, and transports that gas through Pacific Gas Transmission into Pacific Gas & Electric. PGT is also an affiliate of Pacific Gas & Electric.

Many spot market Canadian imports occur through unregulated marketing affiliates of pipelines that will not accept domestic gas for open access transportation to compete in that market. Through this denial of transportation, they have effectively prevented competition with the imports that they are bringing in through affiliated entities.

While the FERC right now is looking at the affiliated abuses, we do not see any action happening at the FERC on this issue, and we feel that this is something that needs to be looked at very closely because it is a way to import gas into the United States without complying with the requirements of Opinion 256.

Other import contracts have guaranteed Canadian gas fixed percentages of particular U.S. markets, regardless of the price of that gas in the market, in spite of the fact that Canadian gas is more expensive in many of these cases. In these cases, domestic gas cannot compete for that market share, regardless of how much cheaper we make our price.

Yet, as mentioned before, many of these agreements are in what I call the regulatory black hole. The FERC claims that once the ERA approves a transaction, they cannot review that transaction for prudency. But yet, ERA in this regulatory black hole has authorized over 14 trillion cubic feet of imports, compared to current imports of about 1 trillion cubic feet per year.

Yet the ERA has never met an import contract they have not approved. They practice regulatory review by what I refer to as rubber stamp approval.

I would like to also talk for a minute about the Alaska Natural Gas System, which is another example of an unlevel playing field as we see it. There is very little, if any, chance that Alaskan gas will ever move through the Alaskan system.

Yet the waiver package passed by Congress resulted in regulatory concessions that now strongly favor Canadian imports on those facilities. For example, let us look at the Northern Border system, the eastern prebuilt portion. Northern Border has tariffs where all operating costs plus a guaranteed return on and a return of equity is recovered through a demand charge to Northern Natural, Panhandle Eastern, and United.

When Northern Border discounts high and uncompetitive transportation rates because of the costs of the system for Canadian gas, instead of their shareholders absorbing those discounted transportation rates, customers of the sponsoring pipelines pick up those discounts through additional tariffs on transportation.

This results in United States gas subsidizing Canadian imports on those systems through a lower netback price, since producers today are getting what is left after the market deducts the cost of transportation.

We do not feel this type of subsidy even remotely resembles a level playing field when you look at imports. Yet, many importing pipelines and local distribution companies argue that existing import contracts must be honored, as they did in their study between the Canadian Gas Association and the American Gas Association. Yet, we all know that domestic producer contracts have been considered fair game since 1982.

Import contracts between affiliated entities are no more sacred than producer contracts in the United States.

Also, many local distribution companies and their associations claim that conditioning import authorization to require that domestic gas have access to those same markets intrudes somehow or other on state authority.

This argument is totally disingenuous when you realize that those same associations support Order 500, which requires that producers give take or pay credits to interstate pipelines in private contracts when producers are trying to obtain transportation on that system.

These are a few of the inequities that we are concerned about in the way Canadian gas is being imported in the United States. I think it is justifiable to ask if Canadian supplies are so reliable as to justify this preferred status.

And I think, based on history, that answer has to be no. In 1973, during the height of the Arab oil embargo, Canada instituted severe restrictions on crude oil exports to the United States. In the gas curtailment era of the late 1970's, the Canadian Government intervened to restrict import volumes and require a price equal to three times the average United States price.

If this is reliable, I guess I do not understand the meaning of the word "reliable."

While Canadian gas should be allowed to compete in our market—and I want to stress that again—they certainly have not established that their reliability as suppliers justifies giving them both above-market prices and preferred access to some U.S. markets during this time of excess domestic supply.

Thank you.

Mr. WONSTOLEN. Mr. Chairman, I would like to conclude IPAMS' testimony with a set of policy recommendations for your consideration. These are on the last page of the written testimony we have provided you, the first of which, Mr. Chairman, you have assured us will be taken care of, and that is the grandfathering of Opinion 256.

However, as Mr. Wilson has pointed out, that opinion does not apply where the Economic Regulatory Administration has the import authority. So as a conjunct to that, we would ask that the Opinion 256 principles be applied under ERA jurisdiction as well.

The third point is to assure that the benefits granted by the Alaska Natural Gas Transportation System waiver package are not used to provide Canadian gas a competitive advantage or to subsidize those imports.

Fourth would be to assure that transactions between domestic pipelines and their Canadian affiliates do not discriminate against United States producers, such as where we see a guaranteed market share contract.

Fourth would be to require that importing pipelines be open access carriers as a prerequisite to approval of an import license.

The next point would be to eliminate the cross-contract take or pay crediting mechanism of FERC Order 500, which is a disincentive to third party sales affecting only domestic producers.

And the last point would be to enact exploration and production incentives comparable to Canadian programs and to eliminate punitive aspects of the U.S. Tax Code, such as the alternative minimum tax, which apply only to domestic producers.

As you know, Senator Bingaman has introduced a bill which would deal with the ERA issue. Senator Domenici has introduced a bill to deal with some of the incentive issues. And we recommend both of those bills for your consideration.

Thank you.

[The prepared statement of Mr. Wonstolen follows:]

TESTIMONY
of the

INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES

on

CANADIAN GAS & THE FREE TRADE AGREEMENT

before the

SENATE ENERGY & NATURAL RESOURCES COMMITTEE

April 21, 1988

David W. Wilson
Immediate Past President

Kenneth A. Wonstolen
Executive Director & General Counsel

1214 Denver Club Building
Denver, Colorado 80202
(303) 623-0987

The independent oil and gas producers represented by IPAMS have been devastated by the free-fall of crude and natural gas prices in the last several years. The economies of the Rocky Mountain producing states are also feeling this distress. The tax base of producing counties show the largest declines in valuation. For example, four of the largest producing counties in Montana have seen a more than 50% drop in assessed value. The situation is particularly acute with regard to natural gas. While gas production in the top five IPAMS states (CO; MT; NM; UT; WY) has declined by approximately 3% since 1984, the gross value of that production has been cut by about 40%.

The reduction in revenues has been even more dramatic on the federal lands. Gas royalties generated from the top five IPAMS states have dropped by almost 60% since 1984. Besides the impact on the federal treasury, states -- who receive a 50% share -- and Indian tribes also have been impacted.

IPAMS does not assert that these difficulties are solely attributable to Canadian gas imports. However, each MCF of imported gas displaces domestic production and exacerbates the problem. And, when such imports take place under a regulatory regime which provides unfair advantages to Canadian gas, domestic independents cry "foul".

The U.S. has adequate supplies of natural gas for its present and future needs. The U.S.G.S. estimates that there are 155.6 trillion cubic feet of economically recoverable reserves in the lower-48 states, of which 37 TCF are in the Rockies. This represents almost a ten year supply at current consumption levels. The DOE estimates surplus domestic deliverability at 1441 BCF between October, 1987 and March, 1988.

Yet, imports of Canadian gas in 1987 rose 33%, to 989 BCF. This represents 5.4% of the U.S. market. Prognosticators project the Canadian market share rising to 10% within a few years. The Economic Regulatory Administration (ERA) has issued import licenses for over 14 TCF of Canadian gas. The Canadian National Energy Board predicts 1988 gas exports to hit $2.2 billion, contributing to the U.S. trade deficit.

Canadian gas is portrayed as reliable and cheap, a benefit to the U.S. economy. Yet, in 1973, Canada restricted crude exports to the U.S. during the height of the Arab oil embargo. In 1980 the Canadian government intervened to raise gas export prices to a level three times the domestic U.S. price and restricted export volumes by establishing high reserve requirements. As the following table shows, Canadian gas is no bargain:

YEAR	EXPORT PRICE	DOMESTIC PRICE
1978	$2.21	$0.91
1979	$2.60	$1.18
1980	$4.47	$1.59
1981	$4.94	$1.98
1982	$4.94	$2.46
1983	$4.40	$2.59
1984	$3.40	$2.66
1985	$3.15	$2.51
1986	$2.51	$1.94
1987*	2.00	$1.78

*estimated

IPAMS does not oppose "free trade" if it is "fair trade". Unfortunately, fair trade does not describe the current situation with regard to Canadian gas. The problems can be grouped in four broad areas:

1. Pipeline rate structures which give Canadian gas a competitive advantage.
2. Affiliate transactions which favor Canadian gas, even to the extent of guaranteeing market share.
3. Lack of access for domestic producers to the markets being served by Canadian gas.
4. Differential tax and regulatory regimes which place domestic producers at a disadvantage.

Some would argue that FERC Opinion 256, the "as-billed" decision has resolved the first of these issues. Under this ruling, domestic pipelines whose Canadian gas imports are subject to FERC jurisdiction may not automatically pass on the cost of those imports as they are billed by the Canadian supplier. Canadian rate structures allocate many costs -- production and gathering, take-or-pay charges, fixed costs related to return-on-equity, taxes, and certain volumetric charges -- to the "demand" component of the gas tariff. This is a charge paid by the buyer whether or not the gas is actually taken, resulting in an incentive to maximize volumes purchased in order to reduce the overall unit cost.

For domestic gas, these costs are assigned to the "commodity" component of U.S. pipeline tariffs. Thus, domestic gas looks overpriced when compared to Canadian gas on a commodity basis. And, that is just what occurs in some markets. For example, during 1985 and 1986, while Canadian gas was more expensive than domestic gas on a total cost basis (see following table), it was taken first under the California Public Utility Commission "sequencing" rules because it had a lower commodity component than domestic gas.

SoCal Gas Cost -- July, 1985 to June, 1986:

El Paso (domestic)	$3.213
Transwestern (domestic)	$3.404
Pacific Interstate (import)	$4.179

These purchases, as well as other border transactions are not subject to Opinion 256. The ERA has refused to apply the principles of Opinion 256 to its import approvals. Moreover, a government official of Alberta has indicated that one of the first items to be brought up for binational dispute resolution under the U.S.-Canada Free Trade Act (FTA) will be Opinion 256. Pressure has been applied to the FERC, including by the U.S. Department of State, to reverse Opinion 256. Given this history, IPAMS fears that the separate energy consultative mechanism of Annex 905 of the FTA will be used in an attempt to overturn this important tenet of rate equity.

The rate structures of importing pipelines do not establish a "level playing field" for gas sales competition. For example, until Pacific Gas Transmission opened its system, Canadian gas moving to the California spot market would move through Northwest Pipeline to an interconnect with El Paso Pipeline at Ignacio, Colorado. The transportation tariff for moving Canadian gas 1475 miles from the border to Ignacio was 27.59 cents. However, domestic producers adjacent to the interconnect were charged 41.39 cents for a haul of less than 100 miles. these skewed transportation tariffs distort competition and demonstrate the problems that arise when pipelines do not operate with cost-of-service based mileage charges and backhaul rates.

Another set of problems is presented by the regulation of the "prebuild" segments of the Alaska Natural Gas Transportation System (ANGTS). This system will probably never move Alaskan gas; instead, it is being used and expanded to allow Canadian gas to penetrate more U.S. markets. For example, Northern Border has applied to extend its line from Ventura, Iowa, to an interconnect at Tuscola Illinois, a deviation from the Presidentially-approved route for moving Alaskan gas to the eastern U.S.

Under the ANGTS "waiver" package, Northern Border is guaranteed recovery of its cost-of-service, including return-on-equity, through the demand charges of Northern Natural, Panhandle Eastern and United Pipelines, the project participants. Moreover, Northern is allowed by the FERC to discount its transportation charge up to 40 cents to move Canadian gas. This discount is recovered in the transportation tariffs of the three project participants. In other words, domestic producers and consumers are actually subsidizing the transportation of Canadian gas imports on the Northern Border system.

The relationship of Northern Natural, Panhandle and United to Northern Border is illustrative of the second problem area identified by IPAMS -- affiliate transactions. It is only natural for domestic pipelines with investments in Canadian affiliates to favor imports. In the California and Pacific Northwest markets, important to Rocky Mountain producers, Canadian gas has made major inroads due to affiliate relationships.

Fifty percent of the Canadian gas imported into the U.S. -- 461 BCF in 1987 -- moves into California over Pacific Gas Transmission, an affiliate of Pacific Gas & Electric. Of this total, 368 BCF is sold to PG&E by its Canadian production affiliate, Alberta & Southern. In the Pacific Northwest, WestCoast, a Canadian supplier, is guaranteed a 45% market share by its affiliate, Northwest Pipeline. Other import arrangements tie the import price to a percentage of the domestic gas price. There is no way for domestic producers to compete for these markets.

Even worse, domestic gas is often denied access to markets being served by Canadian gas, the third problem area addressed by IPAMS Although a few pipelines have become "open access" transporters under FERC Order 436/500, most have done so pursuant to a case-by-case settlement procedure which departs from the principles of nondiscriminatory transportation. For example, pipelines have not adopted true mileage-based, seasonally-adjusted tariffs, nor do they offer backhaul rates which reflect the cost savings inherent in such arrangements.

Pipelines have also manipulated their monopoly control over transportation service to the benefit of their own marketing affiliates. A particularly blatant example of such abuse was brought to the attention of the FERC by an IPAMS complaint (IPAMS v. Panhandle Eastern). The Commission responded by levying the maximum fine against Panhandle for giving its affiliate, Panhandle Trading Company, "insider information" about its transportation plans. In addition, the FERC has proposed a rule to prevent similar pipeline affiliate abuses. The important point, however, is that the rule will not apply to border facilities under the jurisdiction of the ERA.

The fourth problem area identified by IPAMS relates to the disparity in regulatory and tax treatment of domestic and Canadian producers. For example, FERC Order 500 requires domestic producers seeking third party transportation to give the transporting pipeline an "offer to credit" which allows the pipeline to reduce its take-or-pay liability to the producer on a volumetric basis. The pipeline has the right to choose the contract against which it may apply the credit, including take-or-pay settlements previously negotiated. In some cases, producers will be affected by the movement of gas they no longer even own. FERC Order 500 entails governmentally-imposed, unilateral abrogation of producers' valuable contract rights. Canadian producers do not operate with the same disincentive to the serving of third party markets.

With regard to the financial treatment of domestic and Canadian producers by their governments, there are also clear disparities. Canada does not have a "windfall profits tax". Canada's "alternative minimum tax" (AMT) is at a lower rate than the U.S. version, does not apply to corporations and does not treat drilling expenses as "preference items". Canada offers its producers a drilling incentive equal to 33% of the first $10 million of expenditures, and its producing provinces have enacted royalty holidays to stimulate exploration. By contrast, the domestic oil and gas industry has the highest effective tax rate of any sector, and the AMT actually penalizes high levels of drilling.

In conclusion, IPAMS cannot support the FTA until and unless the existing disparities in the U.S.--Canadian gas trade are remedied. Legislation has been introduced by Senator Bingaman to resolve some of the regulatory problems identified by IPAMS. Senator Domenici has introduced a bill to redress some of the tax disadvantages described in this testimony. These are essential measures to restore the "level playing field" encompassed in the notion of free -- and fair -- trade.

GAS PRODUCTION & REVENUE STATISTICS

	1984	1985	1986	1987*
WYOMING				
TOTAL(BCF)	598.9	599.0	588.9	622.0
FEDERAL	312.1	257.1	235.9	267.6
INDIAN	11.8	8.6	8.4	
$/MCF**	2.88	3.03	2.33	1.78
EST.VALUE($MM)	1725	1815	1372	1108
NEW MEXICO				
TOTAL(BCF)	960.1	994.5	819.7	680.0
FEDERAL	537.6	496.7	374.4	340.1
INDIAN	49.4	22.3	23.9	
$/MCF	2.68	2.71	2.09	1.69
EST.VALUE($MM)	2573	2695	1713	1149
MONTANA				
TOTAL(BCF)	56.9	55.3	51.8	47.6
FEDERAL	18.3	11.3	11.1	19.7
INDIAN	1.5	1.6	1.4	
$/MCF	2.30	1.98	1.76	1.37
EST.VALUE($MM)	122	107	85	65
COLORADO				
TOTAL(BCF)	271.5	383.4	447.1	500.0
FEDERAL	60.6	54.6	44.5	37.6
INDIAN	15.0	13.9	17.8	
$/MCF	2.65	2.66	2.40	1.70
EST.VALUE($MM)	719	1020	1073	850
UTAH				
TOTAL(BCF)	68.1	64.1	56.4	49.3
FEDERAL	41.3	34.9	32.6	28.5
INDIAN	6.4	10.0	6.9	
$/MCF	3.34	3.04	2.38	1.81
EST.VALUE($MM)	227	195	134	89

* 1987 ESTIMATES

** PRICE ESTIMATE, GENERALLY FEDERAL $/MCF

POLICY RESOLUTION
OF THE
INDEPENDENT PETROLEUM ASSOCIATION
OF
MOUNTAIN STATES
CANADIAN GAS & THE FREE TRADE AGREEMENT

IPAMS supports "free trade" if it is "fair trade". Unfortunately, fair trade does not describe the current situation with regard to Canadian gas, and approval of the US-Canada Free Trade Agreement, as proposed, may have the effect of ratifying existing disparities. The problems can be grouped in four broad areas:

1. Pipeline rate structures which give Canadian gas a competitive advantage.
2. Affiliate transactions which favor Canadian gas, even to the extent of guaranteeing market share.
3. Lack of access for domestic producers to the markets being served by Canadian gas.
4. Differential tax and regulatory regimes which place domestic producers at a disadvantage.

Therefore, IPAMS calls on the Administration and the Congress to take the following actions:

Assure that FERC Opinion 256 is "grandfathered" in the Free Trade Agreement (FTA) and is not subject to binational dispute resolution.

Require the Economic Regulatory Administration (ERA) to apply the principles of Opinion 256 to imports under its jurisdiction.

Assure that the benefits granted by the Alaska Natural Gas Transportation System waiver package are not used to provide competitive advantages to Canadian gas.

Assure that transactions between domestic pipelines and their Canadian affiliates do not discriminate against U.S. producers.

Require that importing pipelines be "open access" carriers as a prerequisite to approval of import licenses.

Eliminate the cross-contract take-or-pay crediting mechanism of FERC Order 500, a disincentive to third party gas sales which does not apply to Canadian producers.

Enact exploration and production incentives comparable to Canadian programs and eliminate punitive aspects of the U.S. tax code applied to domestic producers.

IPAMS asserts that implementation of the FTA represents an opportunity for the Administration and the Congress to redress the existing disparities between the treatment of domestic and Canadian natural gas producers.

The CHAIRMAN. Does this represent U.S. IPAA or national IPAA?

Mr. WONSTOLEN. No, this is—we are the Mountain States and we are speaking on our own today.

The CHAIRMAN. All right. Do you know how they feel about the treaty?

Mr. WILSON. I think that their policy is very similar to ours, Senator.

The CHAIRMAN. All right. As a practical matter, it is too late to amend this treaty. I mean, that is always—legislation can be passed, but as a practical matter it is too late, so it is going to be a yea or a nay vote.

Are you recommending that we vote nay or maybe?

Mr. WILSON. In looking at what the association calls for, I think it is a little bit too early to tell. We are not saying to vote nay on the treaty at this time. What we are saying is we think there are some things that can be done in both the regulatory and ultimately the legislative process that could be moved separate from the free trade agreement.

And I think we are reserving judgment on whether we feel it should be voted yes or no, depending upon the progress made by the Administration and frankly the attitude that we see as to whether or not they recognize the problems we are talking about.

The CHAIRMAN. The agreement does not affect existing or future incentives for oil or gas exploration or development and related activities. Are Canadian subsidiaries in the oil and gas sectors—and this question is to anyone. Are those Canadian subsidiaries likely to give their producers a significant cost or pricing advantage in relationship to U.S. domestic producers?

Mr. MCCORMICK. Mr. Chairman, I do not think that is necessarily the case. I think each country has the ability to provide whatever incentives to its producing industry it chooses, as well as taxes.

And if you look at the incentives and tax structures on both sides of the border, there are advantages and disadvantages to each. Corporate tax rates are different, depletion allowances, various other kinds of things.

And I do not think we can necessarily assume that because the free trade agreement would pass or not pass, that on or the other of the countries would necessarily employ incentives. They have the ability to do that today if they want to.

The CHAIRMAN. The other segments of the producing community, do you think the IPAA—do the independents pretty generally oppose this treaty or not?

Mr. WONSTOLEN. The IPAA has testified on this matter on the House side in the Commerce Committee, and they basically presented a policy position virtually identical to the one that we have included in our testimony.

That is, we do not oppose the trade agreement per se, but we ask that existing disparities in trade be addressed so that we enter the free trade era.

The CHAIRMAN. But not necessarily addressed as part of the treaty?

Mr. WONSTOLEN. It could be part of the legislative history, as you suggested. It could be Senator Bingaman's bill, Senator Domenici's bill.

Mr. BUSH. I testified with Danny Conklin, the chairman of IPAA, before the Senate Finance Committee, and I think the characterization is accurate to say, in fact he said quite explicitly, that NPAA does not oppose the free trade agreement. There is no opposition.

And we understand the difficulty you are talking about in actually the handling, the way that the trade agreement is addressed. I think the point that the producing community is trying to make—and it has been misconstrued by some people.

The point is that, as Mr. McCormick just said, you know, basically the outcome of how successful the United States Free Trade Agreement will be will rest within the individual actions taken by the Governments of Canada and the United States. If Canada continues to take the aggressive posture of wanting to be very rapid in its incentives in some areas with respect to oil and gas production and some of that, they may do better for theirs than we may be doing for ours.

And that is the reason in some of the areas we are worried about FERC's Order 500 and those kinds of things, which are harmful to our efforts and particularly when we are trying to compete in an international world where it does not work the other way.

The CHAIRMAN. Gentlemen, thank you very much. You have been very helpful.

[Pause.]

The CHAIRMAN. Next we have an electricity panel, with: Glenn R. Schleede, vice president of New England Electric System; and Thomas Altmeyer, senior vice president of government affairs, National Coal Association. Gentlemen, welcome to the committee, and we will begin with Mr. Schleede.

STATEMENT OF GLENN R. SCHLEEDE, VICE PRESIDENT, NEW ENGLAND ELECTRIC SYSTEM

Mr. SCHLEEDE. Mr. Chairman, my name is Glenn Schleede. I work for the New England Electric System, which serves customers in nearly 1.2 million homes, businesses, and institutions in Massachusetts, Rhode Island, and New Hampshire.

Thank you for the opportunity to appear before you today. I have a lengthy statement that I have provided to the staff, which I hope you will include in the record, and I would merely like to make a few summary comments at this time.

Briefly, the statement makes two principal points: First, that we believe that the United States-Canadian Free Trade Agreement and the electricity imports that we are now receiving and plan to receive are in the United States national and public interest.

The second general point is that we believe that part of the concerns expressed by some members of the coal industry concerning electricity imports is based on incorrect or outdated information about those imports.

Before providing a summary of the details in my formal statement, I would also like to offer for the record a copy of a report on a study recently completed by the Energy and Environmental

Policy Center of the John F. Kennedy School at Harvard University.

It was just released Monday and I will provide a copy for the staff. It is the most complete analysis of the electricity import issue that I have seen to date, and I think you would find it useful in your deliberations.

The CHAIRMAN. Thank you.

Mr. SCHLEEDE. In support of the two general points I have just made, I would like to make eight detailed points. First, while our company is interested in and takes advantage of electricity imports, we are also thoroughly committed to using coal as a key part of our energy mix.

Specifically, New England Electric System took the lead in the utility industry back in the late seventies in converting generating units from oil to coal. We converted six generating units, a total megawatt capacity of 1450 megawatts, from oil to coal.

This conversion, which cost $300 million, has been an environmental and economic success. In 1979 we were 78 percent dependent upon imported oil. This year we get about 45 percent of our energy from coal and about 26 percent from oil.

We are using about three to three and a half million tons of coal per year and avoiding the use of about 13 million barrels of imported oil.

The second example of coal use is that we are a majority owner of a rather unique coal-fired, coal-carrying, self-unloading ship which moves our coal, most of which originates in the Appalachian states. We move that coal from East Coast ports to our plants in New England. This $75 million ship was launched in 1983 and has made 330 round trips and carried nearly 13 million tons of coal so far.

The third example of our coal use is that we have an active program to purchase power from cogenerators and independent power producers. We are now getting about 250 megawatts of power from alternate energy sources, and we have an additional 430 megawatts under contract. This latter group includes two planned coal-fired fluidized bed projects.

In short, we are using coal wherever it is feasible and lowest in cost to our customers.

The second of the detailed points in my statement is that the entire New England region is working hard to diversify its energy sources for electricity. As shown in the statement, the region was 72 percent dependent upon imported oil in 1972. We hope to get that dependency down to 17 percent by 1993, and there are details on this in the statement.

The CHAIRMAN. That is of the region?

Mr. SCHLEEDE. Pardon?

The CHAIRMAN. Regional dependency?

Mr. SCHLEEDE. Yes, in the whole New England region.

The reduction in dependence on oil is being achieved by using coal, nuclear energy, various alternate energy sources, hydro, and of course the electricity imports from Canada. In this connection, I should point out that the diversification of energy supply sources has proven to be sensible policy, not only for the New England region, but for others as well.

The third detailed point, which you have heard many times already, is that Canada is an important source of low cost and secure energy that benefits the United States economy and provides an important market for United States coal, too. Canada of course is our largest supplier of imported electricity, oil, and natural gas.

Canada is a very secure source of imports. Electricity from Canada, for example, is far more secure than oil from the Persian Gulf.

Of course, the electricity exchanges that we do with Canada provide efficiencies which benefit consumers and industry on both sides of the border.

The fourth general point—or the fourth detailed point, I would summarize this by pointing out that provisions of the free trade agreement would help assure that Canada will remain a secure and low cost source of energy imports. You have already been provided details on the agreement by Administration witnesses, so I will not go into those.

The fifth point is that the protectionist measures that have been advocated by some relatively small parts of the coal industry would we believe harm U.S. economic interests. Here I would note that electric utilities have a fundamental obligation to provide adequate and reliable electricity at lowest possible cost.

Low cost imports hold down consumer spending for energy and leave more money for other goods and services, thus providing a way of creating more jobs in other sectors. The low cost imports help hold down electricity bills for U.S. business and industry, helping them to compete in U.S. and world markets.

Studies by DOE and others demonstrate that cutting back on the electricity imports from Canada would result in higher costs for United States customers and increased dependence upon foreign oil.

The sixth detailed point has to do with subsidies, and here I would point out that most electricity purchased from Canada is market priced and not based on costs, as we are familiar in the United States. We would be very happy to be able to be able to purchase electricity from Canada on a cost basis or cost plus the value of the subsidies.

We are paying more than that. The prices for the Canadian electricity is determined in the market on an arm's length basis.

As you have probably heard, the National Energy Board regulations require the Canadian utility selling electricity to the United States recover the costs of providing that electricity, including social costs.

And of course, subsidies provided to electric utilities in Canada are not unlike subsidies provided to some utilities in the United States. Here I am referring primarily to the various taxes and other subsidies provided, principally to coops and public power firms, as well as those of course that are provided fuel producers and transporters to hold down our fuel costs.

The seventh detailed point relates to differences in environmental requirements, and here I would refer you to the Harvard study which I mentioned earlier. That study is the most complete one I have seen that documents that Canadian requirements may be different from, but cannot accurately be described as less stringent than, United States requirements.

The eighth detailed point is the one that seems to have been overlooked most frequently by opponents of imported electricity from Canada. The point is that Canada has a natural competitive advantage, in that it has substantial natural sources of energy that can be recovered at lower cost than the United States.

This includes extensive hydropower resources. That power simply can be provided in the United States and we can buy that power cheaper than we can build our own generating plants. If we did not import the power from Canada, we would be denying low cost electricity to United States consumers and the United States economy.

In conclusion, my detailed statement merely summarizes by pointing out that imported electricity is a secure, low cost source of energy that makes an important contribution to the United States economy. Canada is an important market for United States products and services, and the Free Trade Agreement provides added assurances of a free and fair trade.

There is one additional development, Mr. Chairman, that occurred since my statement was prepared and may be of interest to you, and with your permission I would like to cover it briefly now. And that is the recent electric power failure experienced by the Hydro Quebec system.

Briefly, there was a power failure Monday evening that shut down the Hydro Quebec system. That failure did cut off temporarily certain power being exported to the United States, and I could provide you more details on that if you wish. But there was no significant impact either on the New England power pool, New York power pool, or the PJM.

The power was restored quickly from internal generating sources in New England and New York.

The question has been raised several times by the media since that power failure occurred as to whether that failure dampened enthusiasm for importing power from Canada, and the answer to that of course is no. At the time the arrangements were made with Hydro Quebec, the possibility of a power failure was recognized and the system was designed to handle that.

When the power failure occurred, the system worked as it was designed and thus no significant impact on U.S. electric customers.

That concludes my summary.

[The prepared statement of Mr. Schleede follows:]

THE U.S.-CANADIAN FREE TRADE AGREEMENT AND ELECTRICITY IMPORTED FROM CANADA ARE IN THE NATIONAL INTEREST

- Coal industry concerns about electricity imports are based in part on incorrect information relating to Canadian imports -

A statement for

Committee on Energy & Natural Resources

U. S. Senate

by

Glenn R. Schleede*

April 21, 1988

---

* President, New England Energy Incorporated and Vice President, New England Electric System, 25 Research Drive, Westborough, MA 01582.

THE U.S.-CANADIAN FREE TRADE AGREEMENT AND ELECTRICITY IMPORTED FROM CANADA ARE IN THE NATIONAL INTEREST

- Coal industry concerns about electricity imports are based in part on incorrect information relating to Canadian imports -

A statement for the Committee on Energy and
Natural Resources, U. S. Senate
April 21, 1988

- Summary and Contents -

Page

Introduction.. 1

A. COAL PLAYS AN IMPORTANT ROLE IN SUPPLYING THE ENERGY USED BY NEW ENGLAND ELECTRIC SYSTEM IN GENERATING ELECTRICITY.............. 2

1. Six generating units have been converted from oil to coal, with coal supplying 45% of the energy used to generate electricity... 2
2. A unique coal-fired, self-unloading collier carries coal to our generating stations.. 2
3. Contracts have been signed with cogenerators who plan to use coal in fluidized bed boilers to generate electricity and steam. 2

B. THE NEW ENGLAND REGION IS DIVERSIFYING ITS ENERGY SOURCES FOR ELECTRICITY AND HELPING TO REDUCE DEPENDENCE ON FOREIGN OIL....... 3

1. Oil supplied 72% of the energy to produce electricity for the New England region in 1972 but is expected to supply only 17% by 1993... 3
2. Diversifying energy supply sources has proven to be a sensible policy.. 4

C. IMPORTED ELECTRICITY IN NEW ENGLAND DISPLACES OIL -- NOT COAL..... 4

1. Lowest cost electric generation is brought into service ahead of higher cost sources................................ 4
2. NEPOOL entered into agreements with Hydro-Quebec for substantial amounts of imported electricity at low cost....... 4
3. Under the NEPOOL economic dispatch system, electricity from Hydro-Quebec backs out oil-fired generation.................. 5

D. CANADA IS AN IMPORTANT SOURCE OF LOW COST ENERGY THAT BENEFITS U.S. CONSUMERS AND THE U.S. ECONOMY, AND PROVIDES AN IMPORTANT MARKET FOR U.S. PRODUCTS, INCLUDING COAL......................... 5

1. Canada is now the largest foreign purchaser of U.S. coal....... 5
2. Canada is the largest foreign supplier to the U.S. of electricity, oil, uranium and natural gas........................ 5
3. Canada offers the most secure source of imported energy available to the U.S.. 6
4. Exchanges of electricity among neighboring utilities provides important efficiency gains, helping to hold down costs......... 6
5. Energy trade with Canada is an important source of revenue to permit Canadians to buy U.S. products...................... 7

E. THE U.S.-CANADIAN FREE TRADE AGREEMENT (FTA) HELPS ASSURE THAT CANADA WILL BE A SECURE SOURCE OF LOW COST ENERGY FOR THE U.S. AND A GOOD MARKET FOR U.S. PRODUCTS.............................. 7

F. PROTECTIONIST MEASURES APPLIED TO ENERGY IMPORTS WOULD HARM U.S ECONOMIC INTERESTS.. 7

1. Electric utilities have an obligation to provide an adequate and reliable supply of electricity at lowest possible cost.... 8
2. Low cost energy supplies hold down consumers' energy costs, leaving them more money to spend on other goods and services.. 8
3. Low cost energy supplies help U.S. business hold down costs and compete in world markets.................................. 8
4. A DOE study demonstrates that limiting electricity imports from Canada would drive up consumer costs and increase dependence on imported oil...................................... 8
5. Protectionist measures merely delay the time when actions must be taken to meet competition -- making eventual adjustments even more difficult.............................. 9

G. OPPONENTS OF ELECTRICITY IMPORTS FROM CANADA HAVE INCORRECTLY DESCRIBED THE ROLE OF SUBSIDIES IN PRICING ELECTRICITY........... 9

1. Electricity sold by most Canadian power companies is market priced, not cost based................................... 9
2. Canada's National Energy Board rules require that the export price be at least high enough to recover cost, including explicit and implicit subsidies................................ 10
3. Subsidies provided to Canadian electric utilities are much like those provided to some energy producers in the U.S....... 10
    a. Subsidies in Canada....................................... 10
    b. Subsidies in the U.S...................................... 11

H. CANADIAN ENVIRONMENTAL REQUIREMENTS ARE DIFFERENT FROM, BUT NOT NECESSARILY LESS STRINGENT THAN, U.S. REQUIREMENTS................ 12

1. Sulfur dioxide requirements..................................... 12
2. Environmental implications of Canadian hydro-electric facilities are thoroughly reviewed........................... 13
3. A fair assessment of Canadian environmental requirements is warranted.. 13

I. ELECTRICITY FROM CANADA CAN COMPETE SUCCESSFULLY BECAUSE OF CANADA'S EXTENSIVE HYDRO POWER CAPABILITY........................ 14

J. CONCLUDING COMMENTS... 14

Attachments:

1. Graph comparing sources of energy for supplying electricity for the New England Region - 1972, 1979, 1987, 1993 and 2000......... 15

2. Table showing energy source for electricity in the New England Region - 1972, 1979, 1987, 1993 and 2000......................... 16

3. NEPOOL estimated 1991 Load Duration curve demonstrating that imported electricity displaces oil -- NOT coal -- in New England. 17

THE U.S.-CANADIAN FREE TRADE AGREEMENT AND ELECTRICITY IMPORTED FROM CANADA ARE IN THE NATIONAL INTEREST

- Coal industry concerns about electricity imports are based in part on incorrect information relating to Canadian imports -

A statement for the Committee on Energy and
Natural Resources, U.S. Senate
April 21, 1988

Mr. Chairman and Members of the Committee:

My name is Glenn Schleede. I work for the New England Electric System (NEES) which serves customers in nearly 1.2 million homes, businesses and institutions in Massachusetts, Rhode Island and New Hampshire.

I want to start by thanking you for the opportunity to appear before your Committee to present information that will make two basic points:

. The U.S.-Canadian Free Trade agreement and electricity imports are in the U.S. national and public interest; and

. Concerns expressed by some representatives of the coal industry about electricity from Canada are based in significant part on incorrect information relating to those imports.

More specifically, I will explain:

1. The important role that coal already plays in supplying the energy used by NEES Companies in generating electricity.
2. The importance of diversifying the sources of energy used to generate electricity in New England, which has reduced and will continue to reduce dependence on foreign oil.
3. The role of imported electricity is displacing foreign oil -- NOT coal -- in New England.
4. The advantages to the New England region and the nation of the U.S.-Canadian Free Trade Agreement, particularly as it affects electricity and coal.
5. The disadvantages to U.S. residential and business consumers -- and the overall economy -- of protectionist measures which would interfere with low cost imported energy.

In addition, I will provide facts about the role -- or, more correctly, the lack of a role -- in pricing of imported electricity from Canada that is played by:

. Government subsidies to Canadian electricity producers; and

. Differing approaches in the U.S. and Canada to the reduction of sulfur dioxide emissions from powerplants and industrial facilities.

Electricity from Canada can compete successfully with U.S. sources of electricity because Canada has extensive hydro power capability and can supply a very reliable, secure source of energy.

DETAILS

With that brief introduction, let me turn to the detailed information that supports the above summary points.

A. COAL PLAYS AN IMPORTANT ROLE IN SUPPLYING THE ENERGY USED BY NEW ENGLAND ELECTRIC SYSTEM (NEES) COMPANIES IN GENERATING ELECTRICITY.

Recognizing your interest in coal, I want to start by making clear that coal now plays an important role in supplying the energy used by the New England Electric System (NEES) Companies in generating electricity.

1. Six generating units have been converted from oil to coal, with coal now supplying 45% of the energy we use to generate electricity.

Back in 1979, foreign oil supplied 78% of the energy used by NEES Companies in generating electricity. Starting in 1974, an aggressive program was undertaken to obtain permission to convert 6 generating units from oil to coal. Conversion involved a lengthy process to obtain approvals by appropriate Federal, State and local government agencies and an expenditure of about $300 million.

The conversion program was completed in 1982 and has been an economic and environmental success. We now use about 3.3 million tons of coal each year and avoid the importation of about 12 million barrels of oil. During 1988, coal will supply about 45% of the energy we use to generate electricity.

2. A unique coal-fired, self-unloading collier carries coal to our generating stations.

A NEES subsidiary is the majority owner of a unique coal-fired self-unloading collier that carries coal -- originating principally in West Virginia, Virginia and Pennsylvania -- from East Coast ports to our generating plants in New England. This ship, launched in 1983, makes a round trip each 4.5 days on average, completing about 80 voyages per year. Thus far, it has carried more than 12 million tons of coal.

3. Contracts have been signed with cogenerators that plan to use coal in fluidized bed boilers to generate electricity and steam.

The New England region has experienced rapid increases in the demand for electricity and needs additional sources of supply. NEES Companies have been active in considering all alternatives for assuring an adequate and reliable supply of electricity at lowest cost for our customers. This includes new sources of supply and load management and conservation programs to hold down electricity demand.

Potential sources of supply include independent power producers and cogenerators. NEES Companies now obtain electricity from such sources equivalent to about 250 megawatts of capacity and we have under contract sources equivalent to an additional 420 megawatts of capacity.

Among the cogeneration facilities under contract are two planned cogeneration facilities that will use coal in fluidized bed units. In total, these two facilities would provide the New England region with 254 megawatts of generating capacity.

B. THE NEW ENGLAND REGION IS DIVERSIFYING ITS ENERGY SOURCES FOR ELECTRICITY AND HELPING TO REDUCE NATIONAL DEPENDENCE ON FOREIGN OIL.

The oil supply interruptions and rapid price increases of the 1970's demonstrated to many, including the electric utilities in the New England region, that excessive reliance on any one energy source was not the best way of providing a reliable and adequate supply of electricity at lowest possible cost. Accordingly, actions have been taken to diversify energy sources.

1. Oil supplied 72% of the energy to produce electricity for the New England region in 1972, but is expected to supply only 17% by 1993.

The electric utilities making up the New England Power Pool (NEPOOL) have made great progress in diversifying the energy sources for the electricity needed for the New England region. Attachments 1 and 2 to this statement and the table below shows this progress.

NEPOOL ENERGY MIX - PERCENT BY SOURCE

				Estimated*	
Energy Source	1972	1979	1987	1993	2000
Hydro	7%	6%	5%	4%	4%
Hydro-Quebec	-	-	4%	10%	5%
Nuclear	13%	32%	28%	36%	31%
Coal	4%	3%	16%	16%	14%
Alternates**	-	-	-	6%	5%
Natural Gas	-	-	5%	7%	14%
Oil	72%	53%	32%	17%	26%
Purchases	3%	6%	10%	3%	1%
Total	100%	100%	100%	100%	100%
Gigawatt Hrs.	70,113	83,839	105,137	110,392	129,456

---

* Based on contracts in place plus planned alternate energy and natural gas projects.

** Alternates for 1972, 1979 and 1987 are included in other categories.

As you can see from the above table, dependence on oil has been reduced substantially since 1972, with increased reliance principally on coal, nuclear energy and imports from Hydro-Quebec.

2. Diversifying energy supply sources has proven to be sensible policy in New England and elsewhere.

   The progress made in the New England Region and elsewhere throughout the world has demonstrated that reliance on imported oil can be reduced and that diversification of energy sources reduces the potential impact of interruption of any one source.

   In short, experience has demonstrated that diversification of energy supply sources is a sensible policy.

IMPORTED ELECTRICITY IN NEW ENGLAND DISPLACES OIL -- NOT COAL.

Concerns have been expressed by some people in the coal industry that electricity from Canada may be displacing coal. That concern is not supported by the facts in New England and appears not to be a serious problem in other areas of the U.S.

1. Lowest cost electric generation is brought into service ahead of higher cost sources.

   First, it is important to recognize that 95 electric utilities operating in the New England region have organized themselves into the New England Power Pool (NEPOOL). Among its responsibilites, NEPOOL controls the dispatching of all electricity, regardless of who owns the generating capacity or has signed the contract for purchase of power from outside New England.

   The governing principal in the dispatching of this electricity is that the lowest cost source of supply is dispatched first. Savings achieved by this system of "economic dispatch" are then shared among the participating utilities.

2. NEPOOL entered into agreements with Hydro-Quebec for substantial amounts of imported electricity at low cost.

   In 1983, Hydro-Quebec and New England utility officials reached agreement on the first phase of an arrangement under which the neighboring power systems agreed to build transmission facilities that would enable NEPOOL to import 33 billion killowatt-hours of electrical energy from Hydro-Quebec over an 11-year period beginning in 1986. Phase I transmission facilities with capacity to transmit 690 megawatts of power went into service in 1986.

   In 1985, the parties reached agreement on Phase II which provided for the construction of an expanded transmission interconnection with a total transfer capacity of 2000 megawatts. Purchases from Hydro-Quebec increase the energy diversity of New England's bulk power supplies and are expected to meet nearly 10% of NEPOOL's electrical requirements in 1991.

3. Under the NEPOOL economic dispatch system, electricity from Hydro-Quebec backs out oil-fired generation.

Electricity from Hydro Quebec takes its place among the potential sources of electricity available for dispatch. The price for most of the electricity available under NEPOOL's contract with Hydro-Quebec is based upon a percentage of the average cost of generating electricity with fossil fuels (oil, coal and natural gas) in New England.

Except for a short period of time during 1986, coal has been the lowest cost source of fossil-fueled generation, natural gas obtained on an interruptible basis, the next lowest and oil the highest.

Under the pricing arrangement for electricity from Hydro Quebec, that electricity is almost always cheaper than oil, and has displaced the highest cost fossil-fueled source which, except for the short period during 1986, has been oil -- NOT coal.

Attachment #3 to this statement illustrates NEPOOL's Load Duration Curve & Fuel Mix of Generation. This graph shows the mix of generation sources according to variable cost -- with domestic hydro being lowest, followed by nuclear, coal, imports from Hydro-Quebec, oil and, finally, peaking units (pumped storage and internal combustion generating units).

As you can see from this graph, it is oil and peaking units that are displaced by electricity from Hydro-Quebec. Coal-fired generation is not displaced as long as it remains less expensive than oil-fired generation.

D. CANADA IS AN IMPORTANT SOURCE OF LOW COST ENERGY THAT BENEFITS U.S. CONSUMERS AND THE U.S. ECONOMY, AND PROVIDES AN IMPORTANT MARKET FOR U.S. PRODUCTS, INCLUDING COAL.

Extensive and detailed information, which I shall not attempt to repeat, has already been made available to the Congress by the Executive Branch on the important benefits of energy trade between the U.S. and Canada. However, I will summarize five key points that appear important to your deliberations:

1. Canada is now the largest purchaser of U.S. coal.

First, during 1987, Canada imported nearly 16 million tons of coal from U.S. producers -- the largest amount imported by any one country -- at a price of about $650 million.

2. Canada is the largest foreign supplier of electricity, oil, natural gas and uranium.

Second, Canada is the largest supplier to the U.S. of:

- Low cost electricity produced by hydro-electric plants and by nuclear and coal-fired plants
- Natural gas
- Oil
- Uranium

3. Canada offers the most secure source of imported energy available to the U.S.

Third, great concern is expressed in national energy policy debates over the potential for excessive reliance by the U.S. on foreign energy sources. Often participants in those debates conveniently overlook the substantial differences among the various sources of imported energy.

In fact, there are wide differences in the relative security of the various forms and sources of energy. It is intellectually dishonest to lump together, for example, oil from the Persian Gulf and oil, natural gas or electricity from Canada. The sources of the Nation's imported energy differ widely in terms of:

- Distances,
- Ease of diverting supplies to another buyer,
- Transportation modes,
- Policies of the exporting country,
- Relationships between the importing and exporting countries, and
- Implications of capital investments, particularly in transportation (e.g., transmission lines and pipelines),

Hydro-Quebec, for example, is making a large investment -- approximately $1 billion -- in transmission facilities to bring electricity to New England. That investment will be a wise one only if those lines are used over a long period of time. Thus, there is a strong mutual interest in the continued flow of electricity.

4. Exchanges of electricity among neighboring utilities provides important efficiency gains, helping to hold down cost.

Fourth, the interconnection of utility systems offers important efficiency gains, particularly when the systems have peak loads that occur at different times.

All electric systems must have extra capacity to help assure that electricity will be available in times of peak demand or when generating units or transmission lines are not available, for example, for planned maintenance or unexpected outages.

When neighboring systems are interconnected, they can share electricity, making it unnecessary for each system to have capacity to cover all contingencies. Such interconnections are an important way of avoiding unnecessary capital investments and thus help hold down the cost of electricity for consumers.

The advantages are particularly important when neighboring systems or power pools have different peak demand periods, which is often the case with neighboring systems in the U.S. and Canada. Canadian systems tend to experience their periods of highest demand during the winter. U.S. systems are more likely to experience peak demand during the summer.

5. Energy trade with Canada is an important source of revenue to permit Canadians to buy U.S. products.

   As illustrated above, Canada is an important source of secure, low cost energy and contributes to efficiencies which help hold down costs to U.S. consumers.

   I should also note that the revenue flowing to Canada helps make it possible for Canada to be the largest single market for the export of U.S. goods and services, thus contributing to a stronger economy and more jobs in the U.S.

E. THE U.S.-CANADA FREE TRADE AGREEMENT (FTA) HELPS ASSURE THAT CANADA WILL BE A SECURE SOURCE OF LOW COST ENERGY FOR THE U.S. AND A GOOD MARKET FOR U.S. PRODUCTS.

Executive Branch officials have also made available to the Congress extensive information -- which I will not attempt to duplicate -- on the advantages of the U.S.-Canada Free Trade Agreement in assuring that Canada will continue to be a secure source of low cost energy for the U.S. and a good market for U.S. products.

Instead, I will merely mention several of the provisions pointed out by Department of Energy Officials that have special importance in New England. These particularly important features of the Agreement are:

- Eliminate government-imposed discriminatory pricing in energy trade, assuring that consumers in both countries are treated equitably;
- Prohibit restrictions on imports and exports, including quantitative limitations, import and export taxes and minimum export prices;
- Limit the circumstances under which one country may reduce import from or exports to the other, which will help assure continuing energy supplies to consumers; and

F. PROTECTIONIST MEASURES APPLIED TO ENERGY IMPORTS WOULD HARM U.S. ECONOMIC INTERESTS.

During the past 3 years, the Congress has held a number of important hearings on potential protectionist measures that might be applied to certain sources of imported energy. I recognize that coal producers and miners, in particular, are frustrated when alternative sources of energy are available at lower cost. They are concerned with the loss of potential markets and jobs and would like protection against lower cost competitors.

The desire of domestic coal producers to limit competition is understandable. However, I believe it is also important that your Committee take into account:

. The obligation that electric utilities have to their customers, and

. That protectionist measures limiting access to low cost sources of energy would be detrimental to U.S. consumers and the U.S. economy.

1. Electric utilities have an obligation to provide an adequate and reliable supply of electricity at lowest possible cost.

   As you know, electric utilities have an obligation to provide an adequate and reliable supply of electricity at the lowest possible cost. This is a special problem in the Northeast where electricity costs tend to run higher than the national average.

   As pointed out earlier, NEES has converted 6 generating units to coal to diversify energy sources and provide electricity at lower cost than is possible with the use of oil.

   We have also participated in NEPOOL arrangements to obtain electricity from Canada. Clearly, we would not be interested in importing electricity into New England if it were not a low cost source of supply.

2. Low cost electricity helps hold down consumers' energy costs, leaving them more money to spend on other goods and services.

   Our actions to hold down electricity costs are providing important economic benefits within and outside the New England region. When we are able to hold down electricity costs, individual consumers have more money remaining that can be used to purchase other goods and services produced within New England and elsewhere, thus contributing to a stronger national economy and more jobs.

3. Low cost energy supplies help U.S. business hold down the cost of their products and services and compete in world markets.

   As electric utilities hold down electricity costs, business and industrial customers are able to translate the savings into lower prices. Lower prices benefit their customers throughout the U.S. and make it easier for our business and industrial customers to compete in world markets.

4. A DOE Study demonstrates that limiting electricity imports from Canada would drive up consumer costs and increase U.S. dependence on imported oil.

   A recent analysis by the Department of Energy's Energy Information Administration (EIA) serves to highlight the advantages of imported electricity from Canada. The EIA study analyzed the effects of the elimination of electricity imports from Canada. In brief, that analysis showed that elimination of electricity imports would:

. Increase U.S. coal consumption by about 1 million tons (2 million tons by the year 2000).

. Reduce exports of U.S. coal to Canada by 4 to 5 million tons.

. Increase oil imported into New England by more than 65%.

. Sharply increase electricity prices in New England.

Other studies show similar results.

5. Protectionist measures merely delay the time when actions must be taken to meet competition and make eventual adjustments more difficult.

U.S. coal producers and miners have done an excellent job, particularly during the past six years, in improving productivity and bringing down coal prices. Undoubtedly, these actions have helped keep U.S. coal competitive in many markets. Still, the challenge to maintain or improve competitiveness remains and more actions -- particularly in bringing down high transportation rates -- will be necessary.

While protectionist measures are often tempting, experience in the U.S. has often demonstrated that such measures drive up costs for U.S. consumers, selectively harm other sectors of the economy, and merely delay the time when adjustments are made because of the need to become more competitive. Furthermore, once adjustments become inevitable, experience has demonstrated that they are often more painful to individuals, organizations and regions than they would have been if adjustments had been made earlier to improve productivity and bring down costs and prices.

G. OPPONENTS OF ELECTRICITY IMPORTS FROM CANADA HAVE INCORRECTLY DESCRIBED THE ROLE OF SUBSIDIES IN PRICING ELECTRICITY FROM CANADA.

During the past year, certain opponents of imported electricity from Canada have attracted considerable attention. Those opponents have incorrectly described the role of subsidies in pricing electricity from Canada. Four points concerning the role of subsidies are particularly important:

1. First, electricity sold by most Canadian power producers is market priced, not cost based.

The assertions by opponents of imported electricity from Canada have ignored the fact that electricity sold by most Canadian power producers to U.S. utilities is market-priced rather than cost-based.

The fact that this point is overlooked is understandable since most electricity sold within the U.S. is regulated and the price charged is based upon the cost of providing that electricity, commonly referred to as "cost of service" regulation.

Most Canadian electricity sales to U.S. utilities are market-priced. Prices for Canadian electricity are negotiated on an "arms length" basis between the Canadian utility and the U.S. utility purchaser. Those negotiations typically take into account the alternative sources of electricity available to the buyer.

2. Second, Canada's National Energy Board rules require that the export price be at least high enough to recover costs, including explicit and implicit subsidies.

Electricity exports to the U.S. must be approved by Canada's National Energy Board (NEB). The NEB has had three criteria that must be met before an export permit was granted:

a. The export price must recover the appropriate share of costs incurred in Canada. In a June 1987 decision, the NEB made clear that the export price must include all costs borne by Canada, including environmental, land use and economic costs associated with the imports. The NEB's June 1987 decision also made clear that the export price must include both implicit and explicit subsidies.

b. Canadian exporters must demonstrate that the price they are charging will not be less than the price they give Canadians for equivalent services in related areas. The NEB has insisted that electricity be offerred to neighboring Canadian provinces before an export license is approved.

c. Exporters were required to demonstrate that the price they were charging would not be less than the least cost alternative in the purchasing utility's franchise area.

This third test is eliminated by the terms of the U.S-Canada Free Trade Agreement, thus helping to assure that the imported electricity will be priced at market rates.

3. Third, subsidies provided to Canadian electric utilities are much like those provided to some energy producers in the U.S.

The third point that is often overlooked is that governments in the U.S. provide certain subsidies to some energy producers, including producers of electricity, that are much like those provided to Canadian producers of electricity.

a. Subsidies in Canada.

In Canada, subsidies include:

- Canadian electricity producers are generally provincially owned crown corporations and thus excluded from paying either Federal or provincial corporate income or sales taxes.

- Long-term debt of Canadian provincial utilities may be guaranteed by provincial governments, thus resulting in lower interest rates.

- Less responsibility to pay a return on equity investments from provincial governments.

In addition, some subsidies may be involved in the form of:

- Government appropriations.
- Government provided accident insurance for nuclear facilities.
- Water royalties at less than true economic cost.
- Relatively high debt to equity ratios, made practicable by the government backed debt.

b. Subsidies in the U.S. Similar subsidies are certainly not unknown in the U.S. Some electric utilities in the U.S. -- principally Co-ops and publicly owned utilities (e.g., municipals, state power authorities, TVA) -- enjoy such subsidies as:

- Freedom from Federal, state and/or local taxes.
- Subsidized loans, with rates well below market levels.
- Loan guarantees, resulting in below market rates.
- Preferential access to low-cost power from hydro-electric projects constructed with Federal tax dollars.
- Forgiveness of prepayment penalties for loans (granted by the U.S. Congress in late 1987, at a cost to the U.S. Treasury estimated to be in the billions).
- Access to financial markets through the Federal Financing Bank, and resulting in below market interest rates.
- Access to tax-free industrial development bonds.
- Low cost or no cost access to water.

Electric utilities and other energy producers subject to Federal corporate taxes have, until the Tax Reform Act of 1986, enjoyed tax benefits in the form of investment tax credits. Rapid amortization of investments for tax purposes are still available though the amortization period was lengthed by the 1986 Tax Act.

In addition, the coal industry has benefitted somewhat from such subsidies as:

- Federally funded research, development and demonstration, and
- Forgiveness of substantial interest charges on funds borrowed from the U.S. Treasury by the Black Lung Trust Fund.

The U.S.-Canada Free Trade Agreement does not at this time eliminate subsidies on either side of the border.

H. CANADIAN ENVIRONMENTAL REQUIREMENTS ARE DIFFERENT FROM, BUT NOT NECESSARILY LESS STRINGENT THAN, U.S. REQUIREMENTS.

Another argument made by opponents of electricity imported from Canada is that Canada has less stringent environmental requirements than the U.S., thus giving Canadian electricity an unfair cost advantage.

The facts about environmental requirements certainly deserve attention. In summary, as explained below, Canadian environmental requirements are different from, but not necessarily less stringent than, U. S. requirements.

1. Sulfur dioxide requirements. The principal focus of opponents to imported electricity appears to be on sulfur dioxide, since Canadian citizens and the Canadian government have been very critical of such emissions from U.S. powerplants and have claimed that they contribute substantially to "acid rain" falling in Canada.

   A comparison of the sulfur dioxide situation in the U.S. and Canada reveals the following:

   a. Provincial governments have the primary authority to set ambient air quality standards and impose emisssion controls to achieve them. The Canadian federal government has more limited authority than the U.S. federal government.

   b. By mid-1987, five provinces (Ontario, Quebec, New Brunswick, Alberta and Saskatchewan) had adopted enforceable ambient sulfur dioxide (and nitrogen oxides) standards that are different from, but not necessarily less stringent than, U.S. ambient standards.

   c. The Canadian federal government has negotiated an acid rain control program with the seven Eastern Canada provinces which are the principal sources of sulfur emissions (Ontario, Quebec, Manitoba, New Brunswick, Nova Scotia, Newfoundland and Prince Edward Island) which would reduce sulfur emissions by 35% from 1980 actual emission levels by 1994; i.e., from a total of 3.8 million tons to 2.5 million tons.

   d. The province of Ontario which was the largest contributor of sulfur dioxide emissions in 1980 (1,773 thousand tons) has agreed to reduce emissions by 60% (to 885 thousand tons) by 1994.

      I understand that Ontario Hydro -- which is a significant user of U.S. coal -- has recently committed to spend over $3 billion to install scrubbers on three of its largest coal-fired generating plants.

   e. The province of Quebec which was the second largest contributor of sulfur dioxide emissions in 1980 (1,098 thousand tons) has agreed to reduce emissions by 45% (to 600 thousand tons) by 1994.

f. The agreed upon provincial emission limits are in terms of total tonnage reductions, allowing provinces to come up with the most cost effective way of achieving that target.

2. Environmental implications of Canadian hydro-electric facilities are thoroughly reviewed.

   In Canada, jurisdiction over environmental impact of hydro generation is vested in Provincial governments. Quebec, Manitoba and British Columbia each have differing procedures for the review of new generating projects.

   According to information published by the National Energy Board, all three require environmental impact assessments. In Quebec, the provincial cabinet has final authority to approve a project. The Ministry of Environment provides an Environmental Impact Statement at least 45 days prior to the Cabinet decision. During that time, any citizen may request a public hearing on the project, the results of which are considered by the Cabinet in its decision. In Northern Quebec, approval of projects is based on agreements negotiated with Indian and Inuit groups, represented by the Federal Department of Indian and Northern Affairs.

   Furthermore, electricity cannot be exported from Canada without an export license from the National Energy Board (NEB). The NEB's formal review procedure includes public hearings and an opportunity for intervention by all interested parties. NEB must find that the price is "just and reasonable" in order to grant an export license. The NEB broadly interprets this criterion to require that all costs are to be recovered. The NEB's review includes environmental and social impacts, and other aspects of full social costs.

3. A fair assessment of Canadian environmental requirements is warranted.

   Those who criticize Canadian environmental requirements should keep two important points in mind:

   a. Environmental requirements in Canada are different from requirements imposed in the U.S. However, Canada differs substantially from the U.S. in terms of industrial structure, geography, division of powers among levels of government and many other ways. It is unfair to pick out one part of U.S. environmental regulation in isolation and seek an identical requirement in the Canadian system to determine relative stringency of the requirements.

   b. Looking for a Canadian counterpart for the U.S. New Source Performance Standards (NSPS) -- which, in effect, require installation of scrubbers -- is unrealistic.

It must be kept in mind that adoption of a scrubber requirement in the U.S. was in part designed to protect markets for high sulfur coal. In many cases, scrubbers are not the most cost effective means of achieving emission reductions or ambient air quality standards. It appears that the Canadians have adopted a more cost effective approach.

I. ELECTRICITY FROM CANADA CAN COMPETE SUCCESSFULLY WITH ELECTRICITY PRODUCED IN THE U.S. BECAUSE CANADA HAS SUBSTANTIAL CAPABILITY TO PRODUCE LOW-COST ELECTRICITY, PARTICULARLY FROM HYDRO SOURCES.

The underlying factor that is often ignored by opponents of imported electricity from Canada is that Canada has substantial capability to produce low cost electricity because of an important natural resource in the form of massive hydro power.

This natural resource can be turned into hydro-electricity and transmitted to the U.S. at lower cost than electricity can be produced from fossil fuels in large parts of the U.S.

Canadian electricity is a highly reliable and secure source of energy that can be used to displace insecure sources of imported energy, principally imported oil.

J. CONCLUDING COMMENTS.

In brief summary:

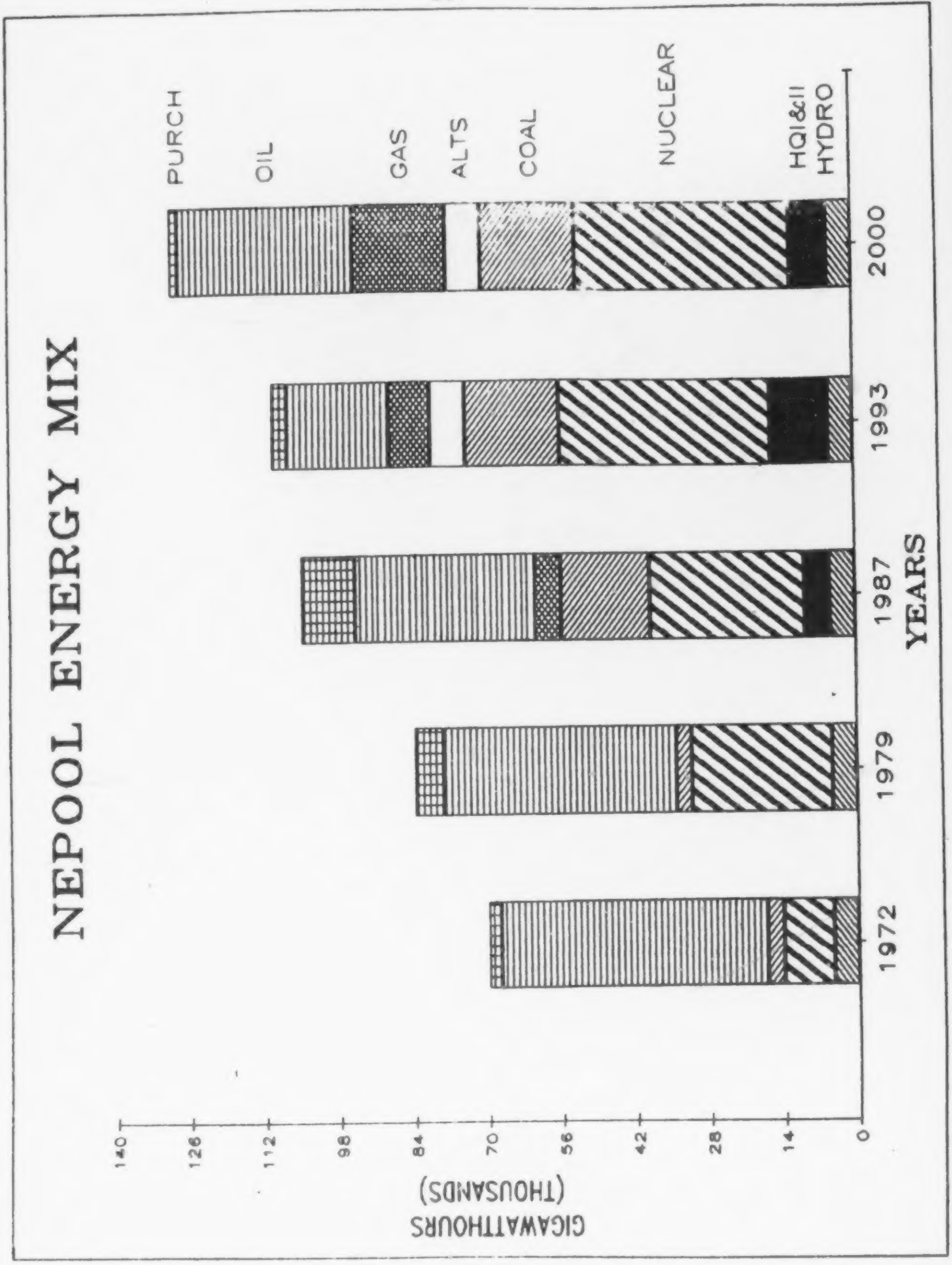
- Imported energy from Canada provides secure, low cost energy sources that make an important contribution to the economic strength and energy security of the U.S.

- Canada provides an important market for U.S. products and services, including a market for some 16 million tons of coal.

- The U.S.-Canada Free Trade Agreement provides added assurances of free and fair trade, benefitting the citizens of both countries.

ATTACHMENT #1

-15-



ATTACHMENT #2

NEW ENGLAND POWER POOL (NEPOOL) ENERGY MIX
- In Gigawatt Hours -

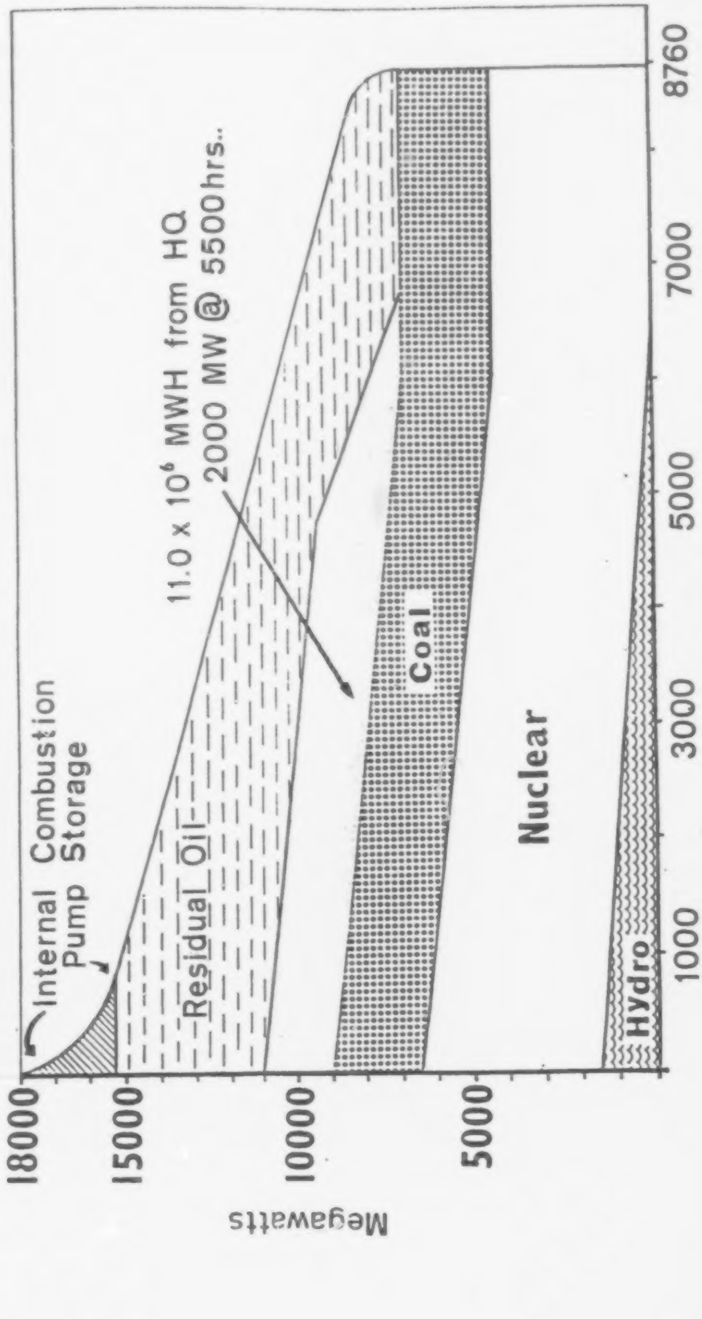
	Actual			Projected	
Energy source	1972	1979	1987	1993	2000
Hydro	4,802	4,748	4,940	4,716	4,702
Hydro Quebec	0	0	4,773	11,000	7,000
Nuclear	9,383	26,732	29,321	40,133	40,585
Coal	3,053	2,804	15,868	17,794	18,048
Alternates	(a)	(a)	(a)	6,735	6,734
Natural Gas	0	0	4,988	7,815	17,665
Oil	5,0651	44,208	34,062	19,216	33,026
Purchases	2,224	5,347	10,185	2,983	1,696
Total(b)	70,113	83,389	105,137	110,392	129,456

(a) Alternates is included under other categories in the 1972, 1979 and 1987 columns.

(b) Totals include pumped storage losses.

ATTACHMENT #3

NEPOOL - 1991 Load Duration Curve & Fuel Mix of Generation



The CHAIRMAN. Thank you, Mr. Schleede.

Mr. Altmeyer.

STATEMENT OF THOMAS ALTMEYER, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, NATIONAL COAL ASSOCIATION

Mr. ALTMEYER. Thank you, Mr. Chairman.

Mr. Chairman, the National Coal Association supports the concept of free trade embodied in the Free Trade Agreement. However, National Coal is concerned that adverse consequences to the United States coal industry may result from an increase in electricity imports and a dimunition in the ability of coal producers in the United States to compete with their Canadian counterparts. Both could result in lower coal production in the United States than would otherwise be expected.

The further significant question exists on the authority and the ability of the Canadian federal government to fulfil its commitments where conflicts exist with the provinces. We recommend that the Congress evaluate the concerns raised by these issues within the context of the FTA.

Without a doubt, the Free Trade Agreement encourages and facilitates freer trade in almost all areas, including energy, and should enhance the energy security of the United States by reducing dependence on foreign non-Canadian oil in the near term, although it may precipitate greater oil imports in 2000 and beyond.

The Free Trade Agreement, however, raises a number of questions which Congress and the Administration must evaluate in implementing legislation. How would the Free Trade Agreement in a regulated commodity, such as energy, operate? This trade is not similar to trade in manufactured goods and services.

Provincial and state laws, as well as federal laws and regulations, now dictate the way interstate and intrastate and international trade in a regulated commodity takes place, including the general way the commodity is priced.

A number of unanswered questions are presented by the Free Trade Agreement. For example, how will the Free Trade Agreement affect FERC regulation of interstate power transactions when those transactions are international in nature as well?

Does the Free Trade Agreement override ERA's authority to issue presidential permits for international transmission of electricity? Will the FTA override state PUC jurisdiction over electricity transactions if those transactions are international?

Does FERC have jurisdiction over the price of those transactions if the state does not?

These questions, as well as others, Mr. Chairman, have not been addressed by the representatives of the U.S. government in their presentations, I believe, to this Committee or to other Committees of the Congress.

Canada has agreed in its part of the Free Trade Agreement to eliminate its least cost price text for exports, while retaining the requirement that exported power cannot be priced at a lower level than the price charged for domestically produced power.

However, under the Free Trade Agreement there is no ceiling on the price of exported power. There is no constraint on a Canadian utility charging more for exported power than the price charged domestically. A Canadian utility could subsidize rates for industrial users in Canada with revenues gained from export sales.

Such a practice could contribute to a further erosion of the energy intensive industrial base of the United States if Canadian utilities choose to offer subsidized power rates as a lure to relocation or siting of new energy-intensive manufacturing or production facilities in their service areas.

There is nothing in the Free Trade Agreement that precludes such a practice. It could well be in the economic interest of Canada to pursue such a practice.

Mr. Chairman, the U.S. coal industry is in a unique position with respect to trade with Canada. Canada is our largest foreign customer. We export an average of 15 to 16 million tons annually.

However, the potential exists that the coal industry could lose domestic markets as a result of the increase in electricity imports. Since 1970, we have experienced a sixfold increase in electricity imports. In 1987, the level was 47 billion kilowatt-hours at a cost of over $1.1 billion.

Electricity exports are projected to continue to increase to a net peak of 63 billion kilowatt-hours in 1995. Although this only represents about two percent of total electricity generated in the United States, regional dependencies are significant.

The New England states are dependent for 9.2 percent of their needs. New York State is 12 percent dependent, and the North Central states are 7.3 percent dependent on imported power.

Although this historical trade has been on an interruptible basis, most of the increase has been and will be on firm power imports. Basically, these utilities will be deferring new construction of new generating capacity as a result of the firm power commitments from Canadian exporters.

This power is being sold under long term contracts obligating the utilities to import a guaranteed amount of power and requiring Canadian utilities to supply the power. These arrangements can be very attractive to U.S. utilities. However, this strategy is not without risk to the U.S. power generation infrastructure, as these contracts are delaying capacity decisions to some future date.

As long term contracts with Canadian utilities expire, because these contracts do not equal the life span of, for instance, a domestic coal-fired powerplant, capacity to replace the contracts will be required.

Well before that time, the utility will have to begin its own construction program, possibly at higher costs than currently available, will have to bid for generating capacity from third party producers, or will have to begin renegotiating with Canadian producers. That is, assuming the Canadian utility does not need the power for domestic markets.

The Canadians clearly recognize the advantages to their utilities and their economy from exporting to United States markets. The Canadian government actively encourages the export of power.

As stated by Marcus Massey, Energy, Mines, and Resources Minister, in remarks to the Canadian Electrical Association in Ottawa this past fall:

> Canadians are right to try to expand their electricity exports. Why? Several reasons. Electricity construction projects create jobs and provide a market for Canadian industrial products.
>
> Electricity developments lead to new technologies and can help us develop our engineering expertise to be sold around the world. Electricity exports generate profits and thereby raise the national income. Electricity exports, expecially hydroelectric exports, also come back to us.

In explaining that, he used illustratively a hydroelectric facility can last for 100 years or longer:

> Suppose we sign an export contract for 25 years. Then with the contract in hand, we build our project. The export revenues will pay for it.
>
> Then when the 25 years are up, the facilities come back to us. For the next 75 years, the electricity is ours to do with as we wish. We can either consume it ourselves or export it again. This is literally a way of turning rain into money.
>
> The export market is there. The U.S. may require as much as 100,000 megawatts of new capacity by the year 2000.

Mr. Chairman, we are completing an update of a preliminary analysis we did that covered 1981 through 1986 on the amount of coal displaced by imported power. In 1986, we estimated that level to be approximately 6.3 million tons. Our projections are that as much as 24 million tons of United States coal could be displaced by Canadian power in the year 1995.

Mr. Chairman, the increase in electricity imports is occurring for two reasons: Canadian utilities may have cost advantages available by virtue of their status as crown corporations and because of the type of generating capacity available.

The second reason is that U.S. public policy and regulatory practices discourage utilities from building facilities necessary to meet their own electricity requirements.

With respect to the first, the free trade agreement does not address identification and elimination of subsidies which affect free and fair trade. However, article 1907 of the agreement does establish a working group on unfair pricing and trade practices.

We would recommend the language be put in the implementing legislation to direct the working group within a time certain to assess, identify, and quantify subsidies available to either United States or Canadian——

The Chairman. That is the language where?

Mr. ALTMEYER. Pardon me?

The Chairman. You say language directing the working group. Language where?

Mr. ALTMEYER. In article—well, article 1907 of the Free Trade Agreement——

The Chairman. It is not amendable, you know.

Mr. ALTMEYER. In the implementing legislation gives specific direction to the working group on the tasks to be taken on and accomplished under article 1907. And what we would recommend is that the bilateral panel on unfair trade practices and pricing practices be directed to assess whether or not——

The Chairman. Directed in what instrument? By what means?

Mr. ALTMEYER. In the implementing legislation.

The Chairman. That is not amendable, is it? Once it is officially transmitted up here, it is not amendable.

Mr. ALTMEYER. Our hope would be that interested members of—I believe the National Coal Association is not the only group that has a concern about the failure of the United States negotiators to address the issue of subsidies in negotiating the agreement with the Canadians.

They have said with us: We were up against a deadline; it was an important issue to us; but if we wanted an agreement, we could not address the subsidy question; therefore, we inserted the bilateral panel to address it over the next 5 years.

We would recommend that members interested contact the Administration and request that the Administration put direction to the bilateral panel in the implementing legislation that they submit to the Congress. We were told by the Administration this should be set up some time in early June.

We recognize, Senator, as you pointed out, that once that legislation is submitted it is not amendable. The changes would have to be inserted by the Administration in the implementing legislation that it submits.

On the domestic side, Mr. Chairman, we recommend that Congress look at United States laws and regulations that put United States domestic utilities at a competitive disadvantage to Canadian utilities. Some U.S. utilities choose to import power rather than to build their own generating facilities to meet demands because it is a lower risk option.

High costs of construction, uncertain and ever-changing environmental regulations and standards, and state PUC prudence reviews, in addition to other factors, combine to make utilities reluctant to plan for the future, while creating a ready market for imported power.

With respect to coal production, structural and policy differences between our two countries result in the United States and Canadian coal industries competing on unequal terms. Canadian mining companies are permitted to deduct all exploration and development expenses. In the United States, we have to capitalize 30 percent of those.

They have a depletion allowance of 25 percent. For coal our current depletion allowance effectively is 8 percent. They have a variable investment tax credit; the United States does not. Canada does not have a black lung tax or an abandoned mineland fee.

Generally speaking, tax costs in Canada represent 1 to 16 percent of the costs of mining a ton of coal. In the United States, tax costs range from 17 to 25 percent of the cost of extraction.

The CHAIRMAN. I understand all these things. We criticized the treaty on that ground. What would you have us do?

Now, we know what you would have the administration do. You would have them give the directions to the bilateral group. I do not know whether the Canadians would say that is consistent with the agreement or not, and my guess is they would not.

What should we do?

Mr. ALTMEYER. In our statement, Mr. Chairman, that is the only recommendation we make that could be incorporated into the implementing legislation, is direction of the bilateral group.

With respect to domestically, on our side of the border, we would recommend that the Congress take a look at the tax treatment of the extractive industries in the United States.

The **Chairman**. We cannot do that, certainly not here. And there is probably not room or time for anybody else to do it. Would you recommend we vote yea or nay, or do you all have a position on that?

Mr. **Altmeyer**. We do not have a formal position yea or nay. We are generally supportive of the Free Trade Agreement. We are concerned, for the reasons outlined in our statement.

We would hope that the Congress, recognizing it may not be achievable in this Congress, but possibly in the next Congress, take a look at leveling the playing field between Canadian and the United States industries on the extractive basis, also on the power production basis.

There are a number of incentives available to Canadian utilities to construct new generation capacity the United States utilities do not have. I think if we are looking at making Canada and the United States an integral economic unit, it is not fair to expect the United States, both producers and electric utilities, to compete in that environment when we are at a disadvantage, in this example, as a result of——

The **Chairman**. I understand the disadvantages. I am trying to get some advice on what we should do.

Mr. **Altmeyer**. We would recommend that you cosponsor legislation that we hope would be introduced some time in the near term, similar to legislation introduced by Senators Domenici and Bingaman for the oil and gas industry. I anticipate similar legislation may be introduced that will level the playing field for the coal industry.

With respect to electric utilities, I would recommend that the committee, this committee, at some appropriate time take a look at the energy security study compiled by the administration, that was publicly made available approximately a year ago, and evaluate why our U.S. utilities are not building new generation capacity.

It is an extremely complex issue. This committee is looking into a number of facets of it. We are concerned because that is our domestic market.

I think a larger concern is raised because, to the extent that our utility systems become dependent upon imported power, they then at the expiration of the contract term for importing that power, if they do not have backup generating capacity, are putting themselves basically at the whim of——

[The prepared statement of Mr. Altmeyer follows:]

NATIONAL COAL ASSOCIATION

Statement

Thomas Altmeyer

Sr. Vice President, Government Affairs

National Coal Association

on the

Canada - U.S. Free Trade Agreement

before the

Energy and Natural Resources Committee

United States Senate

April 21, 1988

Mr. Chairman, my name is Thomas Altmeyer, Sr. Vice President Government Affairs of the National Coal Association (NCA). I am accompanied by William Hynan, Sr. Vice President, Law (NCA), and Connie Holmes, Sr. Vice President Policy (NCA). The National Coal Association is an organization representing producers of coal from the smallest to the largest, operating in all producing regions of the country and mining all qualities of coal. NCA member operations comprise the majority of the commercial coal production in the United States.

We commend you for holding these hearings to explore the effects that the Canada - U.S. Free Trade Agreement (FTA) will have on United States industries and appreciate the opportunity to review the coal industry's position on the FTA.

SUMMARY OF NCA POSITION

NCA supports the concepts of free trade that are embodied in the FTA. NCA is concerned, however, that adverse consequences to the U.S. coal industry may result from an increase in electricity imports and/or a dimunition of our ability to compete with Canadian coal producers in U.S. and Canadian markets. Both could result in lower coal production in the United States than would otherwise be expected. Further, a significant question exists on the authority, and thus the ability, of the Canadian federal government to fulfill its commitments where conflicts exist with the provinces. We recommend that the Committee evaluate the concerns raised by these issues within the context of the FTA.

We would suggest four actions, two directly related to consideration of implementing legislation, and two that are separate and apart, that would be first steps in putting the United States and Canada on a more equal basis in the area of coal and electricity.

First, we would suggest that the working group on subsidies established by Article 1907 of the FTA be given specific direction, within time certain, to assess, identify and quantify all subsidies available to either Canadian or U.S. utilities in order to facilitate trade balancing actions.

Second, appropriate agencies should be directed by the Administration to address the federal and state regulatory problems that act as disincentives to the construction and operation of coal fired power plants and constrain U.S. utilities ability to compete with Canadian power.

Third, legislation should be considered to provide U.S. coal producers tax incentives similar to those available to Canadian coal producers.

Finally, the Congress should obtain clarification of the question of the authority, and thus the ability, of the Canadian federal government to enforce the provisions of the FTA in the provinces when conflicts arise between terms of the agreement and provincial law or regulation.

UNITED STATES COAL AND CANADA

The United States' coal industry is in a unique position with respect to trade with Canada. Canada is the single largest foreign customer for our coal importing an average of 15 - 16 million tons annually. However, the potential exists that the coal industry could be effected by the loss of domestic markets due an increase in the importation of electricity on a firm power, or long term contractual, basis. Our thoughts on the FTA must consider both these factors and carefully weigh the advantages of export to a market that could increase with the potential loss of domestic markets.

Canada is the United States' Largest Foreign Coal Customer

In 1987, Canada imported 16.2 million tons of coal from the United States. The next two largest customers, Japan and Italy, took 11 and 9.5 million tons respectively. With very few exceptions, Canada has, for many decades, annually ranked as first on the list of foreign customers for U.S. coal.

The U.S. ships both steam and met coal to Canadian customers. Most of this coal, mined in the Appalachian coal fields is shipped to customers in the eastern provinces.

Met coal is exported to Canadian steel mills from captive mines in West Virginia and from other U.S. producers in Appalachia. We expect this trading relationship, which last year contributed almost $700 million towards a favorable balance of payments and provided employment for approximately 5000 miners throughout the Appalachian region, to continue to benefit the U.S. coal industry and the economies of both countries.

Steam coal goes to Ontario Hydro and cement and industrial plants in Ontario and Quebec. U.S. steam coal exports could increase from current levels if utility companies in the eastern portion of Canada add coal fired capacity, or operate existing coal plants at a greater rate.

Imports of Electricity

At the same time, U.S. imports of electricity have the potential to displace domestic coal markets. U.S. utilities have imported Canadian power for decades primarily on an interruptible basis to meet system peaking and seasonal demands. This two- way trade has been, and will continue to be, beneficial to the reliability and operation of utility systems in both the United States and Canada.

Since 1970, however, we have seen roughly a sixfold increase in electricity imports. In 1986 U.S. imported 39 billion kilowatt hours (KWH) from Canada, in 1987, the figure was approximately 47 billion kilowatt hours. U.S. exports of electricity were 4.7 and 3.5 billion KWH in 1986 and 87 respectively. Imports represent only about 2 percent of total electricity produced in the United States, but regional dependencies are significant. For example, in 1986 the latest year for which data is available, the New England states were dependent upon imported power for 9.2 percent of their needs, New York was 12 percent dependent and the North Central states of North and South Dakota, Minnesota, Iowa and Nebraska (the MAPP electricity region), were 7.3 percent dependent on imported power. [1]

Electricity Imports are Increasing on a Long Term Basis

Although historical trade has been on an exchange, interruptible basis, most of the increase in trade has been, and will be, for firm power imports. This is power under long term contract obligating the utilities to import a guaranteed amount of power and requiring Canadian utilities to supply the power. The Edison Electric Institute has forecast a net peak of 63 billion KWH imports in 1995. Other forecasts, including our own, tend to confirm this estimate. Imports will be to the areas mentioned above: New England, New York and the North Central region. States in the Northwest are also likely to take more power from Canada.

---

[1] Source: "Electricity Transactions Across International Borders - 1986", published by the Economic Regulatory Administration, Office of Fuels Programs, U.S. Department of Energy, OCtober, 1987.

These long term arrangements can appear very attractive to a U.S. utility. As pointed out in a recent report of the Edison Electric Institute [2]: "In the U.S., regulatory, environmental and financial pressures often render it difficult for a utility to add to its generative or transmission capacity". This atmosphere contributed to utilities turning to Canadian imports which may not require large up front capital investments.

This strategy is not without risk to the U.S. power generation infrastructure as these contracts are merely delaying capacity decisions to some future date. As long term contracts with Canada utilities expire, because these contracts do not equal the life span of a domestic coal-fired power plant, capacity to replace the contracts will be required. Well before that time, the utility will have to (1) begin its own construction program, possibly at costs much higher than current costs, (2) will have to bid for generating capacity from third party producers, or, (3) start renegotiating with the Canadian power producers - if the Canadian utility does not need the power for domestic markets. And, as the same EEI report concluded: "Increasing imports, and dependency on imports affect the utility in three ways: loss of utility autonomy in decision making; preemption of electricity supply options that may be less expensive in the long run; rate base exclusion -- capacity purchases are not included in a utility rate base which could result in lower investor returns and a diminishing rate base".

---

[2] "Canada U.S. Electricity Trade: A survey of Current Trends, Costs, Benefits and Issues", Prepared by Thomas Connell, School of Urban and Public Affairs, Carnegie-Mellon University for the Edison Electric Institute, March, 1988.

As markets develop in the U.S., the Canadians clearly recognize the advantages to their utilities and their economy. The Canadian government actively encourages export of power. As stated by Marcus Massey, Energy, Mines and Resources Minister in remarks to the Board of the Canadian Electrical Association in Ottawa this past fall:

> "Canadians are right to try to expand their electricity exports. Why? Several reasons:
>
> --Electricity construction projects create jobs and provide a market for Canadian industrial products;
>
> --Electricity developments lead to new technologies and help us to develop our engineering expertise which can be sold around the world.
>
> --Electricity exports generate profits and thereby raise national income;
>
> "Electricity exports, especially hydroelectric exports, can also come back to us.
>
> " A hydroelectric facility can last for 100 years, or even longer. Suppose we sign an export contract for 25 years. Then, with the contract in our hand, we build our hydroelectric project. The export revenues will pay for it. Then, when the 25 years are up, the facilities come back to us. For the next 75 years, the

> electricity is ours to do with as we wish. We can either consume it ourselves or export it again. This is literally a way of turning rain into money. The export market is there. The United States may require as much as 100,000 megawatts of new capacity by the year 2000."

Effects of Imports on Domestic Coal Production

National Coal Association is currently completing an update of a July, 1987 analysis of the effects that electricity imports have had on the domestic coal industry. This will be made available to the committee in its entirety when completed. Preliminary results, however, indicate that in 1986 electricity imports displaced some 6.3 million tons. Most of the coal displaced was in the North Central region, where about 4.7 million tons of U.S. coal was displaced by imported power. The remainder was displaced coal use in the Northeast.

As electricity imports increase, so does potential coal displacement. Our preliminary analysis, which looks at the next 10 years, indicates that Canadian utilities have the capacity, technological expertise, financing and organization to continue to expand their electricity export markets in all U.S. regions bordering Canada. It is possible, if U.S. utilities do not add utility owned generating capacity or do not purchase domestically generated power from cogenerators or independent power producers, and chose instead to increase power imports, that as much as 24 million tons of domestic coal could be displaced by 1996. The complete analysis will be available by the end of April, 1988.

THE CANADA - U.S. FREE - TRADE AGREEMENT AND ENERGY

With respect to energy trade the FTA expressly prohibits quantitative restrictions, import or export taxes and minimum export or import prices. The agreement seeks to ensure open market access and requires equitable sharing of energy should shortages occur that would otherwise result in abrogation of an existing supply agreement.

Coal is not specifically addressed within the context of the FTA. Coal trade currently takes place with no restrictions. There are no licenses, tariffs, permits, etc. required in either country for coal exports. The FTA does not address the question of production or transportation subsidies or other favorable treatment that might enhance the competitiveness of either coal industry.

In the **electricity** area, Canada has agreed to eliminate National Energy Board (NEB) requirements that electricity exports must be priced at approximately the cost of the least cost alternative to the U.S. purchaser. [3] Canada has also agreed to implement the "surplus" test on electricity exports "in a manner consistent with the FTA."[4]

---

[3] The NEB currently has three pricing tests for proposed exports: (1) the price must be sufficient to recover all costs (including social costs) incurred in Canada; (2) the price charged cannot be less than the price charged a Canadian utility of customer for equivalent service; and (3) the export price cannot be materially less than the least cost alternative of the U.S. purchaser. The NEB can continue to apply price tests (1) and (2) under the FTA.

QUESTIONS RAISED BY THE FTA

Without doubt the FTA encourages and facilitates freer trade in almost all areas including energy and should both enhance the energy security of both nations and assist the United States in reducing our dependence on foreign, non-Canadian, oil. This is a dependence that has grown dangerously large over the last several months. However, we believe that the FTA raises a number of questions which we would hope that Congress and the Administration consider as implementing legislation is drafted.

How will the FTA effect trade in a regulated commodity such as energy. This trade is not similar to trade in manufactured goods or services. Provincial and state laws, as well as federal law and regulations, now dictate the way that inter-state, intra-state and international trade in regulated commodities takes place, including the general way that the commodity is priced.

---

[4] The NEB currently subjects applications for exports of firm contract electricity to a surplus test as well as the three price tests. The applicant utility must prove that the power to be exported is "surplus" to national Canadian needs by offering all neighboring provinces the same quantity of electricity at the same price as that planned for export. If those provinces refuse the opportunity to purchase, the export is deemed "surplus."

A number of unanswered questions are presented. For example:

> How will the FTA affect FERC regulation of inter-state power transactions when those transactions are international in nature as well? Does the FTA override the Economic Regulatory Administration's authority to issue presidential permits for the international transmission of electricity? Will the FTA override state PUC jurisdiction over electricity transactions, if those transactions are international? Does FERC have jurisdiction over the pricing of those transactions if the state does not?

As referenced above, Canada has agreed to eliminate its "least cost" price test while retaining the requirements that exported power cannot be priced at a lower level than the price charged for domestically produced power. However, under the FTA, there is no ceiling on the price of exported power. There is no constraint on a Canadian utility charging more for exported power than the priced charged domestically. A Canadian utility could subsidize rates for industrial users in Canada with revenues gained from export sales. Such a practice could contribute to a further erosion of the energy intensive industrial base in the U.S. should Canadian utilities choose to offer subsidized power rates as a lure to relocation or siting of new energy intensive manufacturing or production facilities in their service areas. Nothing in the FTA would preclude such a practice.

Statements have been made that subsidies available to Canadian utilities by virtue of their status as Crown Corporations allow the utilities to compete an a "more than equal" basis with U.S. utilities in providing long term power for U.S. markets.

Are Canadian utilities at an inherent advantage due to their status as Crown Corporations, established and initially financed by government, with government guarantees of current debt obligations, freedom from taxation, government assumption of exchange rate risks and other benefits?

NCA RECOMMENDATIONS:

The FTA did not address the identification and elimination of subsidies which affect free and fair trade. However, both sides did agree that current laws and procedures dealing with subsidies and dumping would be maintained along with the right to bring countervailing or anti-dumping actions against either country. The right to impose duties or tariffs on energy imports (or the imports of any other commodity) should it be proven that either country is subsidizing its industry are also preserved.

Further, Article 1907 of the FTA establishes a working group to "seek to develop more effective rules and disciplines concerning the use of government subsidies; and to seek to develop a substitute system of rules for dealing with unfair pricing and government subsidization."

Language directing the working group, within a time certain, to assess, identify and quantify subsidies available to either U.S. or Canadian utilities and to recommend ways to offset advantages that these subsidies might afford in electricity trade should be included in the implementing legislation.

On the domestic side, Congress must look at U.S. laws and regulation that put U.S. electric utilities and U.S. coal companies at a competitive disadvantage with Canadian utilities. Some U.S. utilities chose to import power rather than build their own generating facilities to meet demands because it is a lower risk option. High costs of construction, made even higher due to the extended time required to site and permit a plant; uncertain and ever changing environmental regulation and standards; and state public utility commission prudence reviews in addition to other factors combine to make utilities reluctant to plan for the future while creating a ready market for imported power.

With respect to coal production, there are structural and policy differences between our two countries that result in the

U.S. and Canadian coal industries competing on unequal terms. This is in part because the tax structure affecting Canadian mining companies is more favorable.

Canada's federal income tax system has deductions and incentives more liberal than the U.S. Internal Revenue Code. For example, mining companies for Canadian federal tax purposes are permitted to deduct all exploration and development expenses and a depletion allowance of 25 percent. A variable investment tax credit is also provided and the current Canadian federal corporate income tax rate is phasing down to 33 percent in 1989. Canada does not have a Black Lung Tax or an Abandoned Mine Lands Fee which collectively total $1.25/ton for underground coal and $0.90/ton for surface coal in the United States. Taxes, as a percentage of production costs, range from 1 to 16 percent in Canada. In the U.S. the range is from 17 to 24 percent.

The FTA recognizes structural differences but does not provide a clear prescription for dealing with these inherent differences in a circumstance where the two economies are to become essentially one unit. From the perspective of the coal industry we cannot suggest that changes be made in Canadian laws. Rather, we believe that some of the disadvantages inherent in our own system should be modified to make the economic unit envisioned in the FTA equitable for all concerned.

With this goal in mind, we would suggest changes to afford U.S. producers more favorable tax treatment similar to that available to the Canadian coal industry. A move toward a more level playing field could be effected initially through legislation to: restore the percentage depletion allowance to the pre-1983 effective rate of 10 percent; removing half the depletion allowance as a preference item for Alternative Minimum Tax purposes as is done for book income; allowing full expensing rather than partial capitalization of exploration and development costs; and crediting coal companies Abandoned Mine Land payments towards the Superfund Excise Tax liability.

A FINAL CONSIDERATION

A final area of concern which is generic to the underlying rationale for the FTA with respect to energy trade, as well as all trade, is the authority and thus the ability of the Canadian federal government to enforce the provisions of the FTA.

In the United States, the federal government has clear jurisdiction over the states wherever interstate commerce is concerned. In Canada, however, the Canadian federal government does not have the same level of authority over provincial governments. A statement by the Ontario Attorney General, Ian Scott, cites a Privy Council review of a Canadian Supreme Court decision:

> "The Federal Government has the power to make a treaty, the federal government of Canada does not have the power to implement that treaty in areas of provincial jurisdiction."

It can be inferred from this decision, which is applicable law in Canada, that in areas where provincial jurisdiction overrides, the Canadian provinces will not have to abide by the terms and conditions of the FTA. In the United States however, states and industries are bound by the agreement. It would appear that each province may have to ratify the FTA for the same to be true in Canada.

This vitally affects electricity and other energy trade. Provincial governments exercise control over the electric utility industry in two areas: rates, including the review of any potential rate impacts that would occur as a result of proposed export projects; and the development of the electric utility industry within the province to serve both domestic and export customers.

The authority of the Canadian federal government to enforce the terms of this agreement should be clearly delineated before Congress considers implementing legislation. The resolution of these questions could definitely affect the reliability of imported power, or other forms of imported Canadian energy.

The **Chairman**. Let me ask Mr. Schleede about that. I understand you are short of electricity even today and that your projections in the New England region are going to be very difficult, is that correct?

Mr. **Schleede**. That is correct. We have had load growth over the last 5 years in the region exceeding 4 percent per year. We are very short of capacity. We have a completed nuclear plant sitting up at Seabrook. It is all ready to go except for an operating license from the Nuclear Regulatory Commission and the approved emergency plan. That plant could be started up immediately.

The **Chairman**. What is the status now of that emergency evacuation plan?

Mr. **Schleede**. Well, a plan has been submitted that covers the eight towns in Massachusetts. The plant, as you probably know, is located 2 miles north of the Massachusetts border in New Hampshire.

The 10-mile zone for the emergency plan extends 8 miles over into Massachusetts. The State of Massachusetts has refused to participate in developing an evacuation plan. So the utility joint owners in the plant have developed a plan, submitted it to the Federal Emergency Management Administration, FEMA.

And it is currently being reviewed. Once they complete their review and the tests are done, then apparently the decision will be up to the Nuclear Regulatory Commission.

The **Chairman**. You would expect, given the present state of the law, to get that approved, though, would you not?

Mr. **Schleede**. We are still hoping it would be approved.

The **Chairman**. All right.

Mr. **Schleede**. There are other steps we are taking to meet the demand for buying alternate energy from independent power producers, from cogenerators. The New England region is counting on having about 2,500 megawatts of capacity within the next 4 to 5 years from alternative energy sources.

We are participating with an independent power producer in building a gas-fired combined cycle plant at Boroughville, RI. We have extensive load management and conservation programs underway.

The **Chairman**. Well, I know you are doing all those things, but after you do all the things you are still going to be very short. That is why you want to get Canadian electricity, is it not?

Mr. **Schleede**. Yes.

The **Chairman**. Now, you said in your statement that Canadian—I think I copied this down correctly—Canadian gas is cheaper than United States-generated electricity, or Canadian power is cheaper than United States-generated electricity. Did I get that correct?

Mr. **Schleede**. Yes, that is correct.

The **Chairman**. Now, when do your contracts run out on electricity? What is the term of them?

Mr. **Schleede**. There are two phases to the New England power pool arrangement with Hydro Quebec. The first phase started in 1986, in October 1986, and that covers capacity up to 690 megawatts. That is in operation now. That is largely provided when it is surplus to Hydro Quebec.

The second phase——

The **Chairman**. That is interruptible, that is surplus?

Mr. **Schleede**. Yes, that is interruptible.

The **Chairman**. When does that run out?

Mr. **Schleede**. It is about a 10-year deal. About—I am sorry, I believe that one is a 15-year deal. I can look that up or provide it for the record.

The **Chairman**. That is at a firm price?

Mr. **Schleede**. No, it is not a firm price. The price for two-thirds of that power is at 80 percent of the cost of generating electricity with fossil fuels in New England over the past year.

So you add up the cost of generation from our coal-fired plants or oil-fired plants, gas when we can get it, take 80 percent of that, and that's the price for two-thirds of the cost.

The **Chairman**. That's why you said it's cheaper than U.S.-generated power, because by definition it is 80 percent of the cost of oil.

Mr. **Schleede**. It is also cheaper than if we were to go out and build a new generating plant. We are looking at additional generation. In fact, we are going to have to provide additional generation on our system. So we looked at all the alternatives, including coal, oil, gas.

And if we wanted to get more Hydro Quebec power, that would be the cheapest.

Mr. **Schleede**. What is your other one-third cost?

The other one-third of the cost is that 80 percent of the avoided cost of power in New England. In other words, take what is called the decrement of power, the highest cost generating facility that you replace with Hydro Quebec power, you take 80 percent of the cost of that facility.

The **Chairman**. And when this runs out, I am sure they will give it to you at the same price.

Mr. **Schleede**. When it runs out, I am sure we will have to negotiate for the price. At that time, though——

The **Chairman**. At that time they will be able to charge whatever they want to charge, will they not?

Mr. **Schleede**. Well, that is a long time off. The second phase of the contract ends in 2001. We will have to be careful along the way to see whether we want to build additional generating capacity or whether we want to take advantage of additional power from Hydro Quebec.

The **Chairman**. Let me ask the question that Mr. Altmeyer was asking: Why do you not build domestic generating plants?

I mean, surely you must understand that the price of oil is not going to stay where it is, that the price of oil is going to go up immensely, and that you are going to be totally dependent on—I mean, by definition Canada is a foreign source, but an expensive foreign source.

Mr. **Schleede**. The power is under 2 cents per kilowatt now.

The **Chairman**. That is because it took in the cost of oil, that is why.

Mr. **Schleede**. It is still above the cost for Hydro Quebec. It costs Hydro Quebec very little and they are making money on the sales, even though it costs us less than what it would cost to generate our own power.

The **Chairman**. It does today because the price of crude oil is at historic lows, and the price of crude oil is not going to stay at historic lows. To say we are okay because the price of natural gas or the price of crude oil is down low and therefore we can build our future based on the fact that it is going to stay there I think is not very prudent.

Mr. **Schleede**. Hydro Quebec has lots of capacity now that they are willing to sell. They have the capacity to build another 18,000 megawatts of capacity at James Bay. They have an economic incentive to continue selling that power into the United States.

They can make money doing it. They can sell it cheaper than we can build power plants. There will be——

The **Chairman**. How long a term will they give it to you for?

Mr. **Schleede**. We have it for 10 years now, and that was by mutual agreement.

The **Chairman**. Ten years is not very long in the life of a plant. I mean, that is just long enough to get you dependent on it. It is just long enough—it is about how long it takes to build one.

Mr. **Schleede**. We fully expect that there will be power there after this contract runs out. There will be transmission lines in place.

The **Chairman**. You better hope so, because it is going to be your only source of power.

Mr. **Schleede**. We expect that it will be a cheap source of power, too.

The **Chairman**. Why do you expect the price of crude oil to stay where it is?

Mr. **Schleede**. The electricity from Canada currently is related by formula to the cost of generating electricity in New England. But Canada is going to have a significant economic incentive to continue exporting power after the year 2000, when those current contracts run out.

They will have all the capacity built. There is no serious possibility that they are going to use all the existing capacity plus all of the additional capacity that they can use.

They are going to want to export that power, I believe. We will be a good market for them. We do not intend to get all of our power from them. By 1991, New England will be about ten percent dependent on the Hydro Quebec power. We plan to continue using our own generation. We will take the cheapest form that we can get. We will continue building our own generation where that is possible.

The **Chairman**. You are going to continue to build your own generating plants?

Mr. **Schleede**. Yes. We just announced plans about two weeks ago to repower one existing facility and add another 300 megawatts of capacity to that one.

The **Chairman**. A hydro?

Mr. **Schleede**. No, it is currently an oil-fired unit. It burns oil during the winter and burns gas when gas is available and is cheaper than oil. It is in Providence, RI.

We are going to repower that with natural gas starting—we hope to have that on line in 1995. That will provide us an additional 300 megawatts of capacity.

There are alternate energy sources around New England anxious to build additional capacity. Those, not all of them will get built because some of them are rather ambitious, but a lot of them will get built.

There will be additional generating capacity built. Our whole aim is to stay—to keep our energy sources, our electricity sources, diversified, not get overly dependent on any one of them.

The CHAIRMAN. Well, I guess it is unfair to criticize New England too strongly, because what you are doing is just reacting to federal policy which we have had a hand in making up here, which is to make both coal and nuclear very uncertain as to its future, its regulatory pattern in the future, and therefore its cost.

But it seems to me a very unwise policy, whoever is responsible for that policy, and perhaps it is us, a very unwise policy to in effect place your future on the price of crude oil. And that really is what is being done, crude oil and natural gas.

That is exactly what is being done, because you are afraid of coal and you are afraid of nuclear. And ten years from now, I think the cost of generation by coal and by nuclear is going to be as it was a few years ago, a fraction of the cost of generation by oil.

But in some respects I guess it is better if you are an electric generation company to be short of electricity, having blackouts and brownouts, rather than to be in bankruptcy because they would not let you pass through your cost of your plant.

Mr. SCHLEEDE. We prefer neither of the above.

The CHAIRMAN. Right.

I think Senator Evans came in first. Senator Ford, I have got to go to a budget meeting. Would you mind presiding?

Senator FORD. I will be glad to.

Senator EVANS. Mr. Schleede, how do you understand the U.S.-Canada agreement as it relates to future prices of electricity? Do you believe that the Canadians in the future, if this agreement were adopted, could sell you electricity at a higher price than they charge for the same electricity to their own customers?

Mr. SCHLEEDE. While the agreement as I understand provides for so-called national treatment, my understanding is they can sign contracts that would actually be a higher cost to us than to Canadian producers.

At the same time, they have a tremendous capacity to produce electricity at very low cost compared to what we can do in the United States, and they can make money by selling that electricity and we expect that it will be cheaper than what it will cost to build generating capacity in the United States.

Senator EVANS. That would not necessarily depend on the price of oil at all, would it?

Mr. SCHLEEDE. There is no necessary relationship with oil price. At the present time, by contract, the formula in the contract is tied to the cost of generating fossil fuels for two-thirds of the cost.

Under the second phase of the agreement——

Senator EVANS. You mean in your agreement with Canada?

Mr. SCHLEEDE. Yes.

Senator EVANS. Is that based on fossil fuels or is it based on your highest cost production?

Mr. **Schleede**. Two-thirds of the electricity imported is based on the average cost of generating fossil fuel—generating electricity with fossil fuels in New England—oil, coal, and gas.

The other one-third is based on 80 percent of the avoided cost of the highest cost plant.

Senator **Evans**. Some portion of the first portion would relate to oil prices?

Mr. **Schleede**. Yes.

Senator **Evans**. But it would not necessarily—but that is the current agreement?

Mr. **Schleede**. That is the current agreement.

Senator **Evans**. Presumably, if they had a huge excess of power when the agreement ran out and oil prices had gone to $50 a barrel, you would negotiate.

Mr. **Schleede**. Yes, we will undoubtedly have to negotiate a price.

Senator **Evans**. But it might or might not have much to do with the price of oil at that point?

Mr. **Schleede**. That is correct.

Senator **Evans**. Let me get back to the question. When you say national treatment, under article 3 of GATT do you believe that, when it says "each party shall accord national treatment to the goods of the other party in accordance with existing provisions of article 3 of GATT, including its interpretive notes," when that is combined with section—or article 904 on energy exports, that that would still leave them unconstrained in their charges for export powers compared with domestic?

Mr. **Schleede**. I cannot give you a technical answer to that one. I had not focused on that point or had our lawyers focus on that question. We have not been faced with it, since we have contracts in place that last through the end of the century here. We have not worried a whole lot about that one.

Senator **Evans**. So you do not know for sure?

Mr. **Schleede**. I cannot say for certain what the correct interpretation is.

Senator **Evans**. OK.

Mr. Altmeyer, you make a pretty definitive statement when you say "There is no constraint on a Canadian utility charging more for exported power than the price charged domestically."

Have you carefully examined the combination of article 501 and article 904 and believe that that is true?

Mr. **Altmeyer**. Senator, our observation is primarily based upon the fact that there is nothing in the agreement that says that the price charged domestically in Canada has to be the same as the price charged to the United States. Article 904 of the agreement is only triggered when there is a national shortage invoked by Canada.

There it would require proportional sharing of the reduction of the amount of the commodity being exported. That would be the only time that there would be a constraint on what Canadians do, is under a situation where article 904 is triggered and in place.

Senator **Evans**. Well, how do you interpret article 501, which says the provisions of national treatment under article 3 of GATT, including its interpretive notes?

Mr. ALTMEYER. Senator Evans, I am not in a position to answer that question. I will get a legal opinion for you and submit it for the record. But I am not able to answer your question with respect to article 501. I am not specifically familiar with it.

Senator EVANS. The essence of article 501, you should accord another party no treatment less favorable than treatment provided to your own people, does that not sound pretty much like you have the same treatment across the border?

Mr. ALTMEYER. Senator, yes, it does.

Senator EVANS. And I think, for the record, would you reexamine this statement on page 11 of your testimony in light of rereading article 501 and having your legal people take a look at it, because I think that that is at least my understanding of the essence of this agreement, and especially with regard to the energy flow across the border, that there is essentially equal treatment of both domestic and foreign customers.

Mr. ALTMEYER. Senator, we would be happy to. I apologize in advance if our statement is not accurate. Our representations are premised on conversations which we have had with representatives of the Department of Commerce and the USTR.

Senator EVANS. It would be helpful. You may well be right, but if not you may want to correct the statement.

Would you consider the $500 million that we have set aside for clean coal technology to be a subsidy of the American coal industry?

Mr. ALTMEYER. Yes, or to the American electric utility industry.

Senator EVANS. Maybe that is more accurate. So that that would have to go on one side of the ledger if we were to be examining, as I think you suggested, the whole question of a level playing field?

Mr. ALTMEYER. Yes, Senator.

Senator EVANS. I just wanted to—how broadly do we go before we sort of get into esoterics in terms of the level playing field?

The level playing field sounds to all Americans who are sports nuts like exactly the right thing to accomplish, but it sometimes seems to me that we reach out and, to get a level playing field, we want to level the whole earth. Where do you start and where to you stop when you are talking about level playing fields and subsidies?

We get that in the aircraft industry. Boeing and Airbus are going at each other, and Airbus claims that, because Boeing has some military contracts, which are quite separate, that the learning that they get out of the military contracts sort of flows over into the domestic aircraft field and that is a subsidy.

Mr. ALTMEYER. I think the parameters available currently would be what would be considered to be a subsidy under GATT. For example, disparity of environmental laws is non-countervailable. That would not be a subsidy.

However, specifics, the clean coal program you mentioned or assistance by a provincial government to the provincially owned utility with respect to financing, those would be considered subsidies under GATT.

Senator EVANS. Ok. So you would settle for essentially the limits that GATT itself sets forth?

Mr. ALTMEYER. Yes, Senator.

Senator **Evans**. Ok.

I think I have no further questions.

Senator **Ford** (presiding). Fine. Thank you, Senator Evans.

Mr. Schleede, when you have—is your rate charged by the defined surplus which is predicated on a 3-percent growth, and yours has been 5 percent?

Mr. **Schleede**. In terms of our planning?

Senator **Ford**. That is Quebec.

Mr. **Schleede**. I am sorry?

Senator **Ford**. Quebec power's surplus, Quebec power's surplus, defined surplus, is based on a 3-percent growth rate, where yours has been 5?

Mr. **Schleede**. No, I do not happen to know what Quebec's load growth has been. Ours has been———

Senator **Ford**. It has been 5 percent?

Mr. **Schleede**. If it has been in Quebec, I just do not happen to know that. Our growth has been in excess of four percent, our regional growth, in excess of 4½—4 percent for the last 5 years.

Now, the power we get from Quebec under the first phase of this agreement is predominantly surplus power to Hydro Quebec.

Senator **Ford**. So if it is based on 3 percent and yours is at 4 percent and Quebec is at 5 percent, the surplus is not going to be there quite as long as you think it is going to be, is it?

Mr. **Schleede**. Well, Hydro Quebec has already announced that they are expediting the next three generating units, construction of the next three generating units. And I understand they have capacity to add another 18,000 megawatts of capacity at James Bay.

Senator **Ford**. You said that a few moments ago. How long would it take them to construct that? About as long as your contract?

Mr. **Schleede**. Their next three generating units I believe they plan to have on line by 1995. And it does not take them as long to build powerplants as it does us, apparently.

Senator **Ford**. Yes, they let them pollute more than we do and that is the reason they are down here trying to get us to pass the acid rain legislation. There are more Canadians down here walking the halls of Congress than there are Americans.

Mr. Altmeyer, in your testimony—I am sorry the Chairman has left, but I would like to get into a question that he raised at our hearing last Tuesday. In your testimony, you raised a question of the authority of the Canadian Federal Government to implement the free trade agreement in areas of traditional provincial jurisdiction.

At our hearing last Tuesday, as I said earlier, Chairman Johnston raised that question with Ambassador Yeutter, and the Ambassador essentially said that provincial compliance with the free trade agreement was part of the commitment that Canada is making.

Do you concur that this is really a non-issue which really should not be of concern to the United States?

Mr. **Altmeyer**. Senator, we believe that that is an issue that is generic to the underlying rationale for the free trade agreement. We the United States entered into negotiations with Canada. One of the things that I believe the United States saw as a benefit is access to Canadian natural resources as a part of the Free Trade

Agreement, and which the United States would hope to have continued access to those resources.

In the statement that you reference, Senator, we have quoted Ian Scott, who is the attorney general for the Ontario Province. He stated before the Parliament that the Federal Government has the power to make a treaty, the Federal Government of Canada does not have power to implement that treaty in areas of provincial jurisdiction.

He is citing there the reference to a case called the Labor Conventions Case in 1937, which was an appeal from the Canadian Supreme Court to the Privy Council, which is a group of the House of Lords, which was the ultimate law for Canada at that time.

Basically what it said was that the Canadian Government can enter a treaty, but the provinces are not bound by it in areas of provincial jurisdiction.

Senator FORD. I am getting ready to read into the record this item.

Mr. ALTMEYER. Natural resources are a provincial jurisdiction—pardon me?

Senator FORD. I am getting ready to read into the record the case that you are referring to. Go ahead if you want to.

Mr. ALTMEYER. It is just that if a shortage would arise down the road and the United States goes to Canada and says, under the free trade agreement you are supposed to have proportional sharing or you cannot restrict the export, be it oil from British Columbia or gas from British Columbia, you cannot do it under the free trade agreement, our reading of applicable law in Canada would be that Alberta province, for instance say in this case, could tell the Canadian Government: Well, you signed the agreement; we did not sign the agreement; we are not bound by the agreement and Canadian law does not allow you to take action to cause the agreement to be effected.

If that reading or that interpretation is a valid interpretation, I think it raises a very serious question with respect to the natural resource issues under the free trade agreement, which we would encourage the Congress to get an answer from the administration on before they consider the legislation.

Senator FORD. Well, I have done some research in this area since last Tuesday, and I would like to read this, a statement into the record, and ask that the balance be included in the record.

But in the Labor Conventions Case of 1937, I believe which you were referring to, AC 326, the Privy Council held that:

"Jurisdiction to legislate for the purpose of performing the obligations of a Canadian treaty does not"—underscored, "not"—reside exclusively in the parliament of Canada. In Canada, legislative powers are constitutionally distributed between the Dominion and the provinces."

The Council said: "If a treaty affects classes of subjects under provincial jurisdiction, legislation to support the new functions is within the competence of the provincial legislatures only."

It also held that: "The Dominion could not, merely by making a treaty with other countries, vest itself with legislative authority inconsistent with the constitution."

The case dealt with two statutes enacted by the Dominion parliament in accordance with the conventions adopted by the International Labor Organization pursuant to the 1919 Treaty of Versailles, to which Canada was a party. Each statute admittedly affected property and civil rights within each province.

The Council said these subjects are exclusively assigned to the legislatures of the province and there is no constitutional grounds for stretching the Dominion's treaty-making authority to include subjects exclusively in the jurisdiction of the provinces.

The Ontario attorney general, Ian Scott, whom you referred to in your statement, recently referred to the Labor Conventions Case as follows:

> We next turn to the subject matter of the treaty, because the question immediately arises, what happens if the Federal Government makes a treaty and promises to do certain things that it has no power to do?
>
> That question has been decided for us by the Supreme Court of Canada in a case called the Labor Convention Case, in which it basically held that, while the Federal Government has the power to make a treaty, the Federal Government in Canada does not have the power to implement that treaty in areas of provincial jurisdiction.
>
> That is why in our legislature, when a treaty is made to advance some interest of the United Nations perhaps having to do with an arbitration, this committee will have seen certain bills in that behalf. The provinces are asked to implement it within areas of provincial jurisdiction.
>
> It is precisely because the Federal Government has no power, the Federal Government of Canada has no power to implement it in areas that are exclusively provincial under our constitution.

Now, that is pretty hard, I think, and pretty clear. Even a nonlawyer like me can understand what the attorney general of Ontario is saying, and he is laying it out pretty clear.

So if we do not get some straight answers, I think this free trade agreement is not free, it is dead.

I started to say Mr. Chairman. Since I am the Chairman, acting that is, always acting, I am entering into the record, unclassified, telexes from the Canadian government. And I am putting those into the record, and the attorney general of Ontario is the proposer of several of these telexes and the statutory provisions under which he has made his judgment. And I think they are very, very clear.

[The material referred to follows:]

Senator Wendell H. Ford
April 21, 1988

TREATY IMPLEMENTATION AND PROVINCIAL JURISIDCTION IN CANADA

In the Labour Conventions Case, 1937 A.C. 326, the Privy Council of Canada held that jurisdiction to legislate for the purpose of performing the obligations of a Canadian treaty does not reside exclusively in the Parliament of Canada. In Canada, legislative powers are constitutionally distributed between the Dominion and the Provinces. The Council said if a treaty affects classes of subjects under Provincial jurisdiction, legislation to support the new functions is within the competence of the Provincial Legislatures only. It also held that the Dominion could not, merely by making a treaty with other countries, vest itself with legislative authority inconsistent with the constitution.

The case dealt with two statutes enacted by the Dominion Parliament in accordance with the conventions adopted by the International Labour Organization pursuant to the 1919 Treaty of Versailles, to which Canada was a party. Each statute admittedly affected property and civil rights within each Province. The Council said these subjects are exclusively assigned by S.92 to the Legislatures of the Province and there is no constitutional ground for stretching the Dominion's treaty-making authority to include subjects exclusively in the jurisdiction of the Provinces.

The Ontario Attorney General, Ian Scott, recently referred to the Labour Conventions Case as follows:

> We next turn to the subject matter of the treaty becuse the question immediately arises, what happens if the federal government makes a treaty and promises to do certain things that it has no power to do? . . . That question has been decided for us by the Supreme Court of Canada in a case called the Labour Conventions Case in which it basically held that while the federal government has the power to make a treaty, the federal government in Canada does not have the power to implement that treaty in areas of provincial jurisdiction. That is why in our legislature, when a treaty is made to advance some interest of the United Nations, perhaps having to do with arbitration -- this committee will have seen certain bills in that behalf -- the provinces are asked to implement it within areas of provincial jurisdiction. It is precisely because the federal government has no power to implement it in areas that are exclusively provincial under our constitution.

4/18/88

UNCLASSIFIED
DEPARTMENT OF COMMERCE

INCOMING
TELEGRAM

AGE 01 006224 DC0538
09/1953Z
10/2131Z

INFO CCEN-01 OPS-01 /002 A2 V041

RR RUEHDC
DE RUEHON #0586/02 0391955
ZNR UUUUU ZZH
R 091944Z FEB 88
FM AMCONSUL TORONTO
TO RUEHC/SECSTATE WASHDC 6899
RUEHOT/AMEMBASSY OTTAWA 1060
INFO RUEHGA/AMCONSUL CALGARY 1490
RUEHHA/AMCONSUL HALIFAX 0903
RUEHMT/AMCONSUL MONTREAL 2243
RUEHQU/AMCONSUL QUEBEC 0942
RUEHVC/AMCONSUL VANCOUVER 1516
RUEHDC/USDOC WASHDC
BT
UNCLAS SECTION 02 OF 03 TORONTO 0586

DEPARTMENT PASS ELECTRONICALLY TO USTR FOR AMB MURPHY AND MERKIN

USDOC FOR 4300/IEP/WH/DAS/HUGHES AND
4310/EEP/WH/OOC/CAVITT

THE OTHER INTERESTING THING ABOUT THIS TREATY IS THAT UNLIKE THE GATT IT IMPOSES ON THE FEDERAL POWER THE OBLIGATION TO ENSURE PROVINCIAL COMPLIANCE WITH THE TREATY. IN THAT SENSE, OBVIOUSLY, IT IS INTENDED THAT THE FEDERAL GOVERNMENT WILL IN SOME WAY ENSURE THE COMPLIANCE OF EACH OF THE PROVINCES WHERE PROVINCIAL IMPACTS ARE ANTICIPATED.

ON THE UNITED STATES SIDE, THAT IS NOT AS DIFFICULT AS IT IS IN CANADA BECAUSE OF THE AMERICAN "TRADE AND COMMERCE" POWER. IT IS A VERY BROAD POWER AND GIVES VERY BROAD AUTHORITY TO THE FEDERAL AMERICAN GOVERNMENT WITH RESPECT TO ANY COMMERCE THAT GOES OVER A STATE BOUNDARY, WHICH IN A MODERN AGE IS ALMOST ALL COMMERCE. WE HAVE NO "TRADE AND COMMERCE" POWER OF THAT DIMENSION UNDER OUR CONSTITUTION. WE HAVE THESE TWO WATERTIGHT COMPARTMENTS I HAVE DESCRIBED AND IT IS AN INTERESTING QUESTION TO KNOW HOW, IN THE LIGHT OF THE LABOUR CONVENTIONS CASE, THE FEDERAL GOVERNMENT IN CANADA INTENDS TO ENSURE THE COMPLIANCE OF THE PROVINCES WITH ALL THE PROVISIONS OF THIS AGREEMENT AND THE PROVISIONS THAT WILL FLOW OVER THE NEXT SEVEN YEARS AS THE NEGOTIATIONS ON SUBSIDIES, FOR EXAMPLE, DEVELOP.

WHAT WE CONFRONT, I THINK, IS THAT THE UNITED STATES CAN NOW, IF THIS TREATY IS EFFECTIVE, INVOKE AGAINST CANADA AND ITS PROVINCES A TREATY OBLIGATION IN ORDER TO REQUIRE OUR FEDERAL GOVERNMENT TO INTERVENE IN AREAS THAT UNDER OUR CONSTITUTION ARE AREAS OF EXCLUSIVE PROVINCIAL JURISDICTION. HOW THE FEDERAL GOVERNMENT PROPOSES, IN CONSTITUTIONAL TERMS, TO DO THAT REMAINS TO BE SEEN. THEY HAVE NOT SAID AND OUR EFFORTS TO INQUIRE OF THEM HOW THEY PROPOSE TO DO IT HAVE NOT MET WITH SUCCESS BUT THEY HAVE PROMISED TO DO IT. WHAT I FORESEE, THEREFORE, IS THAT WE WILL HAVE TO CAREFULLY OBSERVE HOW THEY INTEND, IN THE IMPLEMENTATION PROCESS, WHICH IS OVER A YEAR AWAY PERHAPS, TO BREACH THESE SECTION 91 AND SECTION 92 CONSTITUTIONAL WATERTIGHT COMPARTMENTS.

THE OTHER DIFFICULTY ABOUT THE EXERCISE--I WILL SAY IT VERY SHORTLY--IS THAT OUR FEDERAL GOVERNMENT TOOK UPON ITSELF IN THIS TREATY TO ENSURE THAT THE TREATY OBLIGATIONS WOULD BE IMPOSED WILLY-NILLY ON THE PROVINCES. THEY IN EFFECT ABANDONED A DEVELOPING SYSTEM OF GOVERNMENT IN CANADA OVER THE LAST 40 YEARS

006224 DC0538

KNOWN AS "CO-OPERATIVE FEDERALISM" IN WHICH BOTH LEVELS OF GOVERNMENT, ON A WIDE VARIETY OF ISSUES, HAD MET IN ORDER TO ADJUST THEIR DIFFICULTIES SO THAT THE OPERATION OF LIFE IN A FEDERAL STATE COULD BE CARRIED ON.

A WIDE RANGE OF ISSUES OVER THE LAST YEAR--TELECOMMUNICATIONS, ENERGY AND SO ON--WHERE THERE WERE DISPUTES AND DIFFICULTIES BETWEEN THE FEDERAL INTEREST AND THE PROVINCIAL INTEREST WERE RESOLVED BY A NEGOTIATING PROCESS WITH THE PROVINCES ON THE ONE HAND AND THE FEDERAL GOVERNMENT ON THE OTHER IN WHICH THERE WERE TRADEOFFS AND ADJUSTMENTS MADE IN THE INTERESTS OF THE COUNTRY AS A WHOLE. THAT WAS KNOWN AS "CO-OPERATIVE FEDERALISM" AND WAS A MODEL THAT HAS WORKED EXTRAORDINARILY WELL, AND INDEED, UNDER THE PRESENT PRIME MINISTER HAS WORKED WELL TO THE ADVANTAGE OF ALL CANADIANS.

THIS TREATY, IF IMPLEMENTED BY THE AMERICAN CONGRESS AND IF THE FEDERAL GOVERNMENT SEEKS TO ENSURE ITS COMPLIANCE, MARKS AN END TO CO-OPERATIVE FEDERALISM BECAUSE THE COMPLIANCE WILL BE TRIGGERED NOT SIMPLY BY CANADA, THE FEDERAL STATE, ASKING THE PROVINCES TO ACT, BUT BY THE UNITED STATES, THE OTHER TREATY-MAKING POWER, INTERVENING EITHER THROUGH THE TRIBUNAL OR ELSEWHERE TO SAY, "OTTAWA, WHETHER YOU WANT TO OR NOT, YOU ARE NOW OBLIGED TO ENSURE PROVINCIAL COMPLIANCE WITH THIS OR THAT PROVISION."...

THIS IS A MAJOR CONSTITUTIONAL CHANGE. IT IS NOT A CONSTITUTIONAL CHANGE IN THE SENSE THAT ANY WORDS IN THE CONSTITUTION ARE GOING TO BE ALTERED. THERE ARE CLEARLY GOING TO BE NO WORDS ALTERED IN THE CONSTITUTION. WE WOULD HAVE TO BE CONSULTED ON THAT. BUT IT IS A MAJOR CONSTITUTIONAL CHANGE IN THE SENSE THAT FOR THE FIRST TIME IN CANADIAN HISTORY OF WHICH I AM AWARE, A FEDERAL GOVERNMENT, IN THE EXERCISE OF ITS TREATY-MAKING POWER, HAS SAID: WE WILL OVERRIDE THE PROVINCIAL INTEREST IF NECESSARY TO COMPLY WITH THIS TREATY AND ACT AT THE REQUEST OF A FOREIGN POWER TO DO SO."

BT
#0586

UNCLASSIFIED
DEPARTMENT OF COMMERCE

INCOMING
TELEGRAM

PAGE 01 006225 DC0832
09/1950Z
10/2132Z
INFO CCEN-01 OPS-01 /002 A2 V041

RR RUEHDC
DE RUEHON #0586/03 0391959
ZNR UUUUU ZZH
R 081944Z FEB 88
FM AMCONSUL TORONTO
TO RUEHC/SECSTATE WASHDC 3100
RUEHOT/AMEMBASSY OTTAWA 1061
INFO RUEHGA/AMCONSUL CALGARY 1491
RUEHHA/AMCONSUL HALIFAX 0984
RUEHMT/AMCONSUL MONTREAL 2244
RUEHQU/AMCONSUL QUEBEC 0943
RUEHVC/AMCONSUL VANCOUVER 1517
RUEHDC/USDOC WASHDC
BT
UNCLAS SECTION 03 OF 03 TORONTO 0586

DEPARTMENT PASS ELECTRONICALLY TO USTR FOR AMB MURPHY AND MERKIN

USDOC FOR 4300/IEP/WH/OAS/HUGHES AND
4310/EEP/WH/OOC/CAVITT
ASDI SAY, HOW THEY PROPOSE TO DO THIS UNDER OUR CONSTITUTIONAL REGIME, I CANNOT SAY AND HAVE SOME DIFFICULTY IMAGINING, BUT THE REALITY IS THAT IS THE PROMISE CANADIANS, BY THE TREATY, MAKE TO OUR AMERICAN FRIENDS. IT WILL BE INTERESTING TO SEE HOW IT IS TO BE IMPLEMENTED AND IT WILL BE INTERESTING TO SEE HOW OUR FEDERAL SYSTEM IS ALTERED AS A RESULT OF THAT EXERCISE.
END QUOTE

3. DURING THE QUESTION PERIOD WHICH FOLLOWED THE FORMAL PRESENTATION, MR SCOTT MADE ADDITIONAL REMARKS EXCERPTS FROM WHICH FOLLOW.
BEGIN QUOTE
OUR HIGHEST COURT HASX
W
OHAT THE TREATY CANNOT BE
ENFORCED BY THE FEDERAL GOVERNMENT BY LEGISLATION ON A PROVINCE. THAT IS THE LABOUR CONVENTIONS CASE.
THAT HAS CREATED A CERTAIN AMOUNT OF DIFFICULTY IN A NUMBER OF AREAS. THE FEDERAL GOVERNMENT WANTED TO ENTER INTO A TREATY TO ENSURE COMMERCIAL ARBITRATION STANDARDS ACROSS THE WORLD--AN IMPORTANT AND HIGHLY CRITICAL COMMERCIAL ISSUE FOR THE BUSINESS COMMUNITY. THEY MADE THE TREATY. THEY CAME TO EACH OF THE PROVINCES. THEY DID NOT SAY THEY WOULD ENSURE COMPLIANCE WITH THE TREATY. THEY KNEW THEY COULD NOT. THEY CAME TO EACH OF THE PROVINCES AND THEY ASKED IF WE WOULD PASS THE IMPLEMENTING LEGISLATION, AND WE ARE IN THE COURSE OF DOING THAT. THAT IS CO-OPERATIVE FEDERALISM.
WHEN IT CAME TO THE GATT, THE FEDERAL GOVERNMENT DID NOT SAY IT WOULD ENSURE COMPLIANCE. IT BUILT IN A MECHANISM, WHICH IS ESSENTIALLY A BEST-EFFORTS MECHANISM, THAT THE FEDERAL GOVERNMENT WOULD UTILIZE ITS BEST EFFORTS TO GET THE PROVINCES TO GO ALONG. I BELIEVE THIS IS ENTIRELY NOVEL. IT IS VERY CRITICAL, BECAUSE MR. YEUTTER IN THE UNITED STATES ORIGINALLY SAID HE WOULD REQUIRE THE UNDERTAKING OF THE PROVINCE. I DO NOT KNOW WHETHER HE IS SAYING THAT NOW, BUT OBVIOUSLY THE FEDERAL GOVERNMENT, KNOWING IT COULD NOT GET THE COMPLIANCE OF ALL THE PROVINCES, IS SAYING, "DO NOT WORRY, MR. YEUTTER, WE ARE GOING TO ENSURE THEIR COMPLIANCE." I DO NOT KNOW WHAT THAT MEANS FOR US, BUT I KNOW IT MEANS MAJOR CONSTITUTIONAL IMPACTS....

006225 DC0832

THE OTHER SIDE IS REALLY FOCUSING ON THE EXTENT TO WHICH THE PRESENT SUPREME COURT OF CANADA WILL REVERSE A DECISION OF A PREVIOUS SUPREME COURT OF CANADA THAT HAS STOOD AS THE LAW OF THE COUNTRY FOR A VERY LONG TIME. HE MAY BE RIGHT. THE SUPREME COURT OF CANADA HAS THE POWER TO REVERSE ITSELF AND IT HAS RARELY, BUT IT HAS DONE SO AND IT MAY DO SO. IT MAY SAY THAT THE LABOUR CONVENTIONS CASE IS NOT THE LAW ANY MORE. I DO NOT BELIEVE THAT IS LIKELY TO BE THE RESULT....
THE WAY WE IN THIS COUNTRY HAVE TRADITIONALLY RESPONDED TO PROBLEMS WHERE THERE WAS A NATIONAL VIEW THAT DECISIONS SHOULD BE MADE ACROSS THE COUNTRY IN AREAS OF EXCLUSIVE PROVINCIAL JURISDICTION--AND THAT IS WHAT WE ARE TALKING ABOUT--IS TO GO TO EACH OF THE PROVINCES AND SAY, "WILL YOU INVITE YOUR LEGISLATURE TO MAKE THESE CHANGES?" THAT IS WHAT CO-OPERATIVE FEDERALISM IS, AND IT HAS NEVER BEEN EASY. IT HAS ALWAYS PRESENTED DIFFICULTIES, BUT IT IS THE WAY OVER THE LAST 40 OR 50 YEARS WE HAVE SUCCEEDED IN GOVERNING A COUNTRY WHERE THERE ARE MANY SECTIONAL INTERESTS THAT CHANGE AND SHIFT.
ON THE OTHER HAND, IF THE VIEW IS--AND I TAKE IT THIS IS THE VIEW--THAT THE FEDERAL GOVERNMENT IS GOING TO ENFORCE THIS IN SOME MYSTERIOUS WAY WITHOUT THAT EXERCISE, THAT IS A CONSTITUTIONAL CHANGE OF REALLY SIGNIFICANT PROPORTIONS THAT, IN MY VIEW, MAKES MEECH LAKE LOOK LIKE NOTHING.
END QUOTE.
BLEVINS
BT
#0586

Canada

UNCLASSIFIED
DEPARTMENT OF COMMERCE

INCOMING
TELEGRAM

PAGE 01 0U6223 DC0534
10/1413Z
--10/2130Z
INFO CCEN-01 OPS-01 3350-01 6410-01 4121-02 6240-01 3120-01
6242-01 4310-02 5102-01 105-01 6420-01 6810-01 6200-01
6440-01 4110-01 6450-01 6140-01 OPT1-01 AENA-01
/022 A2 V041

OO RUEHDC
DE RUEHON #0586/01 0391950
ZNR UUUUU ZZH
R 091944Z FEB 88 VARIOUS ZDKS
FM AMCONSUL TORONTO
TO RUEHC/SECSTATE WASHDC 0098
RUEHOT/AMEMBASSY OTTAWA 1059
INFO RUEHGA/AMCONSUL CALGARY 1489
RUEHHA/AMCONSUL HALIFAX 0902
RUEHMT/AMCONSUL MONTREAL 2242
RUEHQU/AMCONSUL QUEBEC 0941
RUEHVC/AMCONSUL VANCOUVER 1515
RUEHDC/USDOC WASHDC
BT
UNCLAS SECTION 01 OF 03 TORONTO 0586

FEB 9-

DEPARTMENT PASS ELECTRONICALLY TO USTR FOR AMB MURPHY AND MERKIN

USDOC FOR 4300/IEP/WH/DAS/HUGHES AND
4310/EEP/WH/OOC/CAVITT

E.O. 12356: N/A
~~TAGS: ETRD, PGOV, CA~~
SUBJECT: ONTARIOS ATTORNEY GENERAL DEFINES THE PROVINCES STANCE ON THE FTA AND THE CANADIAN CONSTITUTION

REF: TORONTO 319

1. ON FEBRUARY 2, IN AN APPEARANCE BEFORE A LEGISLATIVE COMMITTEE REVIEWING THE FTA, THE ONTARIO ATTORNEY GENERAL (IAN SCOTT) DEFINED AT LENGTH THE OPGS VIEW OF THE CONSTITUTIONAL ASPECTS OF THE AGREEMENT. HE DID NOT STATE, OR THREATEN, THAT THE OPG WILL CHALLENGE THE FEDERAL GOVERNMENT IN THE SUPREME COURT. EXCERPTS FROM HIS PRESENTATION FOLLOW. ALTHOUGH LENGTHY, TAKEN TOGETHER THESE EXCERPTS PORTRAY THE LEGAL CASE THE OPG HAS STAKED OUT. WHAT USE, IF ANY, IS TO BE MADE OF THIS RATIONALE REMAINS TO BE SEEN. ADDITIONAL COMMENTARY ON THE HEARINGS PROCESS WILL BE FOUND IN REFTEL AND IN A SEPARATE CABLE TO BE SUBMITTED BY THIS CONSULATE LATER THIS WEEK.

2. BEGIN QUOTE
IT IS AN OBVIOUS MATTER THAT THE POWERS OF LEGISLATURES TO ENACT LEGISLATION ARE DEFINED BY THE BRITISH NORTH AMERICA ACT, SECTIONS 91 AND 92. THEY ARE SAID BY CONSTITUTIONAL LAWYERS TO BE WATERTIGHT COMPARTMENTS SO THAT ALL POWER TO ACT IN ALL WAYS IN ALL MATTERS IS GIVEN EITHER TO THE PROVINCES OR TO THE FEDERAL GOVERNMENT, SUBJECT TO THE CHARTER, OF COURSE, WHICH CAN INTERVENE. HOWEVER, ALL POWER TO ACT IN THE INTERESTS OF OUR FELLOW CITIZENS IS DIVIDED BY THE CONSTITUTION EITHER IN FAVOUR OF THE FEDERAL GOVERNMENT OR IN FAVOUR OF THE PROVINCES....
A POWER ON THE FEDERAL SIDE THAT IS CLEAR IS THE TREATY-MAKING POWER. THE FEDERAL GOVERNMENT ALONE HAS THE AUTHORITY TO MAKE A TREATY WITH ANOTHER STATE....
IT IS UNDOUBTED THAT THE FEDERAL GOVERNMENT HAS THE RIGHT ON BEHALF OF ALL CANADIANS TO MAKE A TREATY WITH THE UNITED STATES OR ANY OTHER COUNTRY.
WE NEXT TURN TO THE SUBJECT MATTER OF THE TREATY BECAUSE THE QUESTION IMMEDIATELY ARISES, WHAT HAPPENS IF THE FEDERAL GOVERNMENT MAKES A TREATY AND PROMISES TO DO CERTAIN THINGS THAT IT HAS NO POWER TO DO?
THAT QUESTION HAS BEEN DECIDED FOR US BY THE SUPREME COURT OF CANADA IN A CASE CALLED THE LABOUR CONVENTIONS CASE IN WHICH IT BASICALLY HELD THAT WHILE THE FEDERAL GOVERNMENT HAS THE POWER TO MAKE A TREATY, THE FEDERAL GOVERNMENT IN CANADA DOES NOT HAVE THE POWER TO IMPLEMENT THAT TREATY IN AREAS OF PROVINCIAL JURISDICTION. THAT IS WHY IN OUR LEGISLATURE, WHEN A TREATY IS MADE TO ADVANCE SOME INTEREST OF THE UNITED NATIONS, PERHAPS HAVING TO DO WITH ARBITRATION--THIS COMMITTEE WILL HAVE SEEN CERTAIN BILLS IN THAT BEHALF--THE PROVINCES ARE ASKED TO IMPLEMENT IT WITHIN AREAS OF PROVINCIAL JURISDICTION. IT IS PRECISELY BECAUSE THE FEDERAL GOVERNMENT HAS NO POWER TO IMPLEMENT IT IN AREAS THAT ARE EXCLUSIVELY PROVINCIAL UNDER OUR CONSTITUTION.
HAVING SAID ALL THAT, THERE IS NO QUESTION ABOUT THE RIGHT OF THE FEDERAL GOVERNMENT TO MAKE THE TREATY. THEY COULD NOT BE STOPPED BY A PROVINCE BECAUSE THAT IS CLEARLY A FEDERAL RESPONSIBILITY.
WHAT IS THE IMPACT OF THIS TREATY UPON A PROVINCE LIKE ONTARIO? THE FIRST THING TO OBSERVE IS, OF COURSE, THAT THE PRIME MINISTER OF CANADA HAS SAID THE TREATY IS 97 PER CENT FEDERAL. I DO NOT ACCEPT THAT PROPOSITION. I AGREE IT IS 100 PER CENT FEDERAL IF ALL YOU ARE TALKING ABOUT IS THE CAPACITY TO MAKE A TREATY, BUT IF YOU ARE TRYING TO MEASURE ITS IMPACT ON OUR POWERS, IT HAS VERY SIGNIFICANT IMPACTS IN AREAS OF PROVINCIAL JURISDICTION.
THE IMPACT ON THE PROVINCES, FOR EXAMPLE, IS MADE CLEAR BY THE EXTENT OF OBLIGATIONS CLAUSE, ARTICLE 103, WHICH STATES THAT THE AGREEMENT APPLIES TO PROVINCES UNLESS THEY ARE SPECIFICALLY EXEMPTED. OTHER PROVISIONS IN THE AGREEMENT DEAL WITH MATTERS SUCH AS ENERGY, INVESTMENT, SERVICES, PUBLIC MONOPOLIES AND WINE AND SPIRITS, ALL OF WHICH ARE WITHIN PROVINCIAL JURISDICTION.
BT
#0586

937 A.C. 326

[PRIVY COUNCIL.]

J. C.*
1937
Jan. 28.

ATTORNEY-GENERAL FOR CANADA . APPELLANT;

AND

ATTORNEY-GENERAL FOR ONTARIO AND OTHERS . . . . } RESPONDENTS.

ON APPEAL FROM THE SUPREME COURT OF CANADA

Canada—Dominion Statutes—Constitutional validity—Legislation passed in performance of treaty obligations—Property and civil rights in the Province affected—Invalid legislation—Distribution of legislative powers—Based on classes of subjects—Principle unaffected by new international status of Canada—Totality of legislative power In co-operation with Provinces—British North America Act, 1867 (30 & 31 Vict. c. 3), ss. 91, 92 (13), 132—Weekly Rest in Industrial Undertakings Act, 1935. *St. Can.* (25 & 26 *Geo.* 5, *c.* 14)—*Minimum Wages Act,* 1935. *St. Can.* (25 & 26 *Geo.* 5, *c.* 44)—*Limitation of Hours of Work Act,* 1935. *St. Can.* (25 & 26 *Geo.* 5, *c.* 63).

The Weekly Rest in Industrial Undertakings Act, 1935, the Minimum Wages Act, 1935, and the Limitation of Hours of Work Act, 1935, of the Parliament of Canada, which in substance gave effect to draft conventions adopted by the International Labour Organization of the League of Nations in accordance with the Labour Part of the Treaty of Versailles, 1919, and ratified by the Dominion of Canada, were ultra vires of the Parliament of Canada and invalid in that the legislation related to matters coming within the class of subject "Property and civil rights in the Province" which was assigned exclusively to the Legislatures of the Provinces by head 13 of s. 92 of the British North America Act, 1867.

In re Legislative Jurisdiction over Hours of Labour [1925] Can. S. C. R. 505, referred to.

The legislation could not be justified under s. 132 of the British North America Act, which provided that the Parliament of Canada should have "all powers necessary or proper for performing the obligations of Canada or of any Province thereof, as part of the British Empire, towards foreign countries, arising under treaties between the Empire and such foreign countries," because the obligations under the ratified conventions were not the obligations of Canada as part of the British Empire, but of Canada by virtue of her new status as an international juristic person, and they did not therefore arise under a treaty between the British Empire and foreign countries.

In re The Regulation and Control of Radio Communication in Canada [1932] A. C. 304, applied.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

Jurisdiction to legislate for the purpose of performing the obligations of a Canadian treaty does not reside exclusively in the Parliament of Canada: *In re The Regulation and Control of Aeronautics in Canada* [1932] A. C. 54, and *In re The Regulation and Control of Radio Communication in Canada* [1932] A. C. 304, do not afford a warrant for the contrary view.

For the purposes of the distribution of legislative powers between the Dominion and the Provinces under ss. 91 and 92 there is no such thing as treaty legislation as such. The distribution is based on classes of subjects, and as a treaty deals with a particular class of subject so would the legislative power of performing it be ascertained.

No further legislative competence was obtained by the Dominion from its accession to international status and the consequent increase in the scope of its executive functions. There was no existing constitutional ground for stretching the competence of the Dominion Parliament so that it became enlarged to keep pace with enlarged functions of the Dominion executive. If the new functions affected the classes of subjects enumerated in s. 92 legislation to support the new functions was within the competence of the Provincial Legislatures only; if they did not, the competence of the Dominion Legislature was declared by s. 91 and existed ab origine. The Dominion could not, merely by making promises to foreign countries, clothe itself with legislative authority inconsistent with the constitution which gave it birth.

Further, the present legislation was not concerned with matters of such general importance as to justify the overriding of the normal distinction of powers in ss. 91 and 92.

Dicta of Duff C.J. in *In re The Natural Products Marketing Act* [1936] Can. S. C. R. 398, at 414 et seq., approved and applied.

Lastly, in totality of legislative powers, Dominion and Provincial together, Canada was fully equipped to legislate in performance of treaty obligations, but the legislative powers remained distributed, and if in the exercise of her new functions derived from her new international status Canada incurred obligations, they must, so far as legislation was concerned, when they dealt with Provincial classes of subjects, be dealt with by the totality of powers—by co-operation between the Dominion and the Provinces.

APPEAL (No. 100 of 1936), by special leave, from a judgment of the Supreme Court of Canada (June 17, 1936) answering questions referred to the Court by Order of the Governor-General in Council, dated November 5, 1935. The questions referred asked whether the Weekly Rest in Industrial Undertakings Act, 1935, the Minimum Wages Act, 1935, and the Limitation of Hours of Work Act, 1935, or any of the provisions thereof and in what particular or particulars or to what extent, were ultra vires of the Parliament of Canada. The Statutes in question, which dealt with the matters denoted by their titles, were passed by the Dominion Parliament in accordance with conventions adopted by the International Labour Organization of the League of Nations in accordance with the Labour Part of the Treaty of Versailles of June 28, 1919. The conventions had been ratified by the Dominion.

---

* *Present*: LORD ATKIN, LORD THANKERTON, LORD MACMILLAN, LORD WRIGHT M.R., and SIR SIDNEY ROWLATT.

The facts, the relevant provisions of the Treaty of Versailles and of the British North America Act, 1867, appear from the judgment of the Judicial Committee.

In the Supreme Court of Canada, Duff C.J., Davis and Kerwin JJ. were of opinion that, except as to s. 6 of the Minimum Wages Act, the three Statutes were intra vires. Rinfret, Cannon and Crocket JJ. were of opinion that the Acts were ultra vires. The judgments of the Supreme Court are reported at [1936] Can. S. C. R. 461.

1936. Nov. 13, 16, 17, 19, 20 and 23. *R. S. Robertson* K.C., *L. S. St. Laurent* K.C., *C. P. Plaxton* K.C., *Peter Wright* and *R. St. Laurent* for the Attorney-General for Canada. The Statutes deal with the matters their titles indicate. Admittedly the matters dealt with by the Statutes would ordinarily come within head 13 of s. 92 of the British North America Act, and be matters of Provincial concern, and there must therefore be found some ground for taking them out. The Dominion rely on the fact that it was performing a duty under the Treaty of Versailles in compliance with the provisions of s. 132 of the British North America Act. The obligation to enact the legislation arose under the Treaty, and s. 132 applied. If that be not so, in any event the conventions were validly entered into and the obligation to perform them was an obligation of the Dominion of Canada which it could properly discharge by enacting the legislation in question, really making an application of *In re The Regulation and Control of Radio Communication in Canada*. (1) Reliance is also placed on the peace, order and good government aspect of the matter in the same way as it was relied on in the *Radio* case. (1) Against the Dominion, either in the Cases which

en filed or in the reasons in the judgments against the ion, the following questions arise: (1.) That the ion has no power to enter into such conventions with oreign State; (2.) that Canada did not in fact ratify the ations; and (3.) that s. 132 of the British North America has no application. It was further said that, even if da did validly ratify the conventions, the matters to they related were matters on which the Provinces could legislate. [Reference was made to the preamble e Weekly Rest in Industrial Undertakings Act, and to 158, 405, 406 and 407 of the Treaty of Versailles.] Under 405, para. 5, a member having received a draft convention to bring it before the authority within whose competence matter" lay. It is submitted that that related to what called ratification. "The matter" was the matter of cation—there was no convention at that time. If it not ratification but performance, then was the authority whose competence the matter lay the authority who do the act or pass the legislation in performance of the ntion in case it was ratified? Was that the competent rity, or does it mean the authority who would pass such lation if there were no such convention at all? The nion says that it is the former, the Provinces say the r. [Reference was made to *Attorney-General for the* *monwealth of Australia* v. *Colonial Sugar Refining Co.*, (1), and to the draft conventions to show the procedure was followed, and to the reasons and occurrences which, was alleged, accounted for the long delay on the part of nada between the date of the drafting of the conventions Geneva and their acceptance by Canada.]

It is submitted that *In re Legislative Jurisdiction Over* *urs of Labour* (2) was wrongly decided. The *Radio* case (3) the case of a convention, not of a treaty, and therefore 132 of the British North America Act did not apply. The formance of obligations under the conventions is not to nd on whether the subject-matter is one coming within

---

(1) [1932] A. C. 304.

(1) [1914] A. C. 237, 252.

(2) [1925] Can. S. C. R. 505.

(3) [1932] A. C. 304, 311.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

the enumerated heads of s. 92. By the transference of the treaty-making power to the Dominion executive, and correlative power to legislate to carry out the obligation, nothing is taken from the Provinces.

[LORD ATKIN. The Dominion has not got unlimited powers of legislation.]

The residuary clause of s. 91 of the British North America Act is capable of the construction, which is not inconsistent with decided cases, that where Canada has properly incurred an international obligation with respect to any matter whatsoever, that within whatever classes in ss 91 and 92 it may be described as coming under other circumstances, once the matter has assumed the aspect of an international bargain it is no longer to be treated as belonging to any one of the enumerated classes.

[LORD ATKIN. That is a very far-reaching doctrine: it means that Canada could make an agreement with any State which would seriously affect Provincial rights.]

It is a power which cannot be exercised by Canada alone; some other country must be found which is willing to enter into a bargain. This matter must not be looked at as though Canada is going to look about the world to find some one with whom to make an agreement for the purpose of robbing the Provinces of their constitutional rights. But, logically, it must be admitted that whatever Canada and such other country agree to do can be effected by Canada. There are three propositions as to the power of the Dominion to enter into or to advise His Majesty in respect to the making of international obligations: (1.) An obligation arose directly from the Treaty of Versailles, and the conventions in question were entered into under that obligation, and s. 132 of the British North America Act therefore applies to the powers of the Dominion. (2.) Even if the matter cannot be put as high as a treaty obligation, at least under the Treaty of Versailles the necessary power was given to advise His Majesty in respect of such conventions. (3.) By the constitutional developments, particularly since the Treaty of Versailles, the constitutional right to advise His Majesty in respect of

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO

national obligations affecting Canada has become vested his Canadian Ministers. That is sometimes expressed by ying that the right to exercise the prerogative in respect Canadian affairs has been transferred to the Canadian cutive. It is submitted that as to both the second and third the above propositions the power of the Dominion to late in performance of the obligations arises either on a per interpretation of s. 132 of the British North America or on the principles outlined in the *Radio* case. (1) The wer to legislate must be obtained under one or other of those wo heads.

With regard to art. 405, para. 7, of the Treaty of Versailles, ce consent was obtained from the Senate and the House Commons in 1935, and it is submitted that consent was tained, then there was no right to refuse to ratify—it was treaty obligation on the executive Government of Canada ratify.

[LORD ATKIN. How did the consent without legislation the Senate and the House of Commons become a matter hich made them the competent authority?]

First, it is ordinary constitutional practice to ask the approval of the body which will, in the event of the engagement being entered into, have the power to enact the legislation. Secondly, it is the only competent authority to pass the legislation where a convention has been entered into: *Attorney-General of British Columbia* v. *Attorney-General of Canada*. (2) There has been a direct and unbroken chain of obligation existing under the Treaty of Versailles; there has been the agreement of the High Contracting Parties that all these things will be done, step by step, if conditions arising from time to time are fulfilled. Every condition here, it is submitted, has been fulfilled, and there has been consent by the legislative body which alone would have power to carry out the Treaty. The legislation could not be enacted by the Provinces afterwards. Even if the Board should be of opinion that at some point there is a missing link in the chain of obligation, it is submitted that the Treaty of Versailles, and

---

(1) [1932] A. C. 304.
(2) [1924] A. C. 203.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

particularly art. 405, definitely and expressly recognizes the power of Canada to enter into such obligations as a member of the League of Nations and as a member of the Labour Organization.

With regard to the position after ratification, when s. 132 of the British North America Act speaks of obligations as part of the British Empire towards foreign countries, those words describing the international obligation should be given a broad meaning. "Empire" there ought to be read as "His Majesty." The performance of the obligations loses its aspect of being a private matter of the individual inhabitants of Canada and becomes one of nation-wide importance, and not one which is to be divided among the Provinces. The Statutes in question are, with the exception of s. 6 of the Minimum Wages Act, merely in compliance with a treaty obligation: that is all the Dominion professes to do; it has not claimed any broad jurisdiction in these matters as having been taken out of s. 92, but merely seeks to deal with them for this one special purpose. Upon a fair and proper construction of the residuary power it should be deemed to extend to the performance of international obligations. A valid obligation was entered into, and the legislation in question was validly enacted to carry it out. [Reference was also made to Oppenheim's "International Law," 4th ed., 1928, vol. I., p. 194; Anson's "Law and Custom of the Constitution," 4th ed., 1935, vol. II., p. 87; Keith's "Constitutional Law of the British Dominions," 1st ed., 1933, pp. 99–100, and p. 394 et seq.; and to Noel Baker's "The Present Juridical Status of the British Dominions in International Law," 1929 ed., p. 197–8; and *In re Regulation and Control of Radio Communication.* (1)]

Plaxton K.C. followed. The Dominion Parliament has the capacity under the residuary power to give effect to a convention not within the purview of s. 132 of the British North America Act, and that was so held in the *Radio* decision. (2) A matter which may be local and Provincial

---

(1) [1931] Can S. C. R. 541, 545, 551.
(2) [1932] A. C. 304, 311, 313.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

its nature may assume another aspect once the country becomes committed as a whole to some other country under a treaty. [Reference was made to *Fort Frances Pulp & Power Co.* v. *Manitoba Free Press Co.* (1); to Oppenheim's "International Law," 4th ed., vol. I., p. 716; and to Westlake's "International Law," 2nd ed., 1910, pt. I., p. 290, and to *Attorney-General of British Columbia* v. *Attorney-General of Canada.* (2)

A. W. Roebuck K.C., A.-G. for Ontario, and *I. A. Humphries K.C.* for the Attorney-General for Ontario. Sect. 132 of the British North America Act gives no treaty-making power to the Dominion Government, but it does confer on the Parliament authority to carry out the obligations of treaties validly made on behalf of both the Dominion and the Provinces. The argument so far presented leaves the Province as a mere municipal institution, a mere nonentity in Imperial and foreign relations. That was not the intention of the framers of the British North America Act; the Province has obligations to foreign countries. The power given by s. 132 is not an exclusive power; it may be an overriding power.

The authority competent to sign a treaty creating obligations is the King or some authority specially delegated to do so by the King. [Reference was made to *In re The Initiative and Referendum Act* (3), and to *Liquidators of the Maritime Bank of Canada* v. *Receiver-General of New Brunswick.* (4)] There are no grounds whatever for saying that the parties to advise His Majesty in matters relating to the jurisdiction of the Provinces have in some way come to be the Dominion Ministers. The Province has the right to advise the Crown in matters where its legislative powers apply. Ontario has a right to enter into an agreement with another part of the British Empire or with a foreign State. So far as legislative and executive authority are concerned the Governor-General and the Lieutenant-Governors of the Provinces, and the Dominion Parliament and the Provincial

---

(1) [1923] A. C. 695, 704.
(2) [1924] A. C. 203.
(3) [1919] A. C. 935, 941-2.
(4) [1892] A. C. 437, 441.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

Legislatures are equal in status. The Treaty of Versailles is binding on Ontario as part of the British Empire. It is not to be considered that those who drafted the Canadian constitution intended to write a constitution which was subject to defeat in its main provisions by competing jurisdictions. The concentration of power in the hands of the Dominion is fatal to Canada as it has been known in the past. The Statute of Westminster, 1931, does not change a word in the British North America Act. The only place in the Treaty of Versailles where there is a binding obligation that would qualify under s. 132 of the British North America Act is art. 405, para. 5. It is hard to find in the Treaty that the Dominion have anything to do beyond submitting to the competent authority. In any event, the words "authority or authorities" in that paragraph clearly contemplate the possibility of the legislation being carried out in alternative jurisdictions. And the words "within whose competence the matter lies" must mean within whose competence "to legislate" the matter lies: "the matter" is the subject-matter of the conventions, in this instance, the three Acts in question. The competence only went to the Dominion after the obligation confirming ratification became completed. On the strength of the dates and facts as to ratification, the ratification was not in accordance with the Treaty of Versailles, and no obligation rested on Canada or any of the Provinces which might be carried out under s. 132 of the British North America Act. It has been argued that ratification by Canada constituted an agreement in itself as between countries. From the form of the ratification it was not an agreement, but only amounted to an offer. It was not signed by the King, but by the Under-Secretary of State for External Affairs of Canada.

The subject-matter in the *Radio* case (1), and the *Aeronautics* case (2), was in each instance within s. 91, and not within s. 92 of the British North America Act, so that there is a complete distinction between those cases and the present one, except on one ground. If it were held that the present matters were of such national importance, of such wide import as to affect the body politic of the Dominion in the overriding way that was found in *Russell* v. *The Queen* (1), if they were taken out of the specific heads of s. 92, then Ontario is satisfied to see this legislation supported. With regard to the overriding features of this legislation, the Province of Ontario looks on the legislation as good, and believes that it is in the public interest; but they are unfortunate in being called upon to fight a bad principle in connection with a good measure. The Acts are of national importance, and the subject has attained such proportions as to affect the body politic.

---

(1) [1932] A. C. 304.

(2) [1932] A. C. 54.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

J. B. McNair K.C., *A.-G.* for New Brunswick, and *Frank Gahan* for the Attorney-General for New Brunswick. To succeed in supporting the legislation on the Geneva conventions the Dominion must in the final analysis establish two propositions or principles. (1.) That the Dominion has the capacity to create treaty obligations binding on the Provinces; and (2.) that the Parliament of Canada has power to perform such obligations. The first involves the performance of executive power; the second, the performance of legislative power. The word "treaty" is used as meaning international agreements. The Dominion have based their contention that the legislation is valid primarily on the Peace Treaty. If, however, they are driven from that ground, they take the position that the conventions would stand on their own legs. It is submitted, as to the Peace Treaty, that there was no obligation of any kind on which s. 132 of the British North America Act could operate. It was contended for the Dominion that "the matter" in art. 405, para. 5, of the Treaty of Versailles meant the matter of ratification. It is suggested that it means the matter of the proposals. And the question which is the authority which is competent must be determined under the relevant laws of the particular member in relation to the actual matter dealt with by the proposals. Sect. 132 merely gives an overriding power. The subject-matter must be determined having regard to the other provisions of the British North America Act. On the correct view of the provisions of the latter part of the treaty the Dominion obtains no support through the operation of s. 132. That means that in the final analysis the conventions must stand on their own feet without any support whatever from the treaty. Considered on that footing, the first question is, to what executive act of the Dominion authorities can the appellant point as creating by treaty in the broad sense an obligation binding on the Provinces, and which Parliament is competent to perform. It seems obvious, so far as executive acts are concerned on which those conventions standing alone can be founded, that the search is limited to the resolution of the two Houses of Parliament adopting or approving each convention; to the Order of the Governor-General in Council; and to the order or decision of the Cabinet or Ministry.

---

(1) (1882) 7 App. Cas. 829.

Mr. McNair then dealt with the history and development of the treaty-making power in relation to the Provinces of Canada, and submitted the following propositions: (1.) Treaties made by His Majesty as sovereign head of the Empire bind in the diplomatic sense all parts of the Empire, and His Majesty's subjects therein so far as the provisions are applicable thereto. (2.) The treaty-making power is one of the prerogatives of the King which in the aggregate represents the residuum of discretionary sovereign power. (3.) Originally in Great Britain the treaty-making power and the treaty-performing power were vested in the same person. In other words, the King was sovereign in fact as in name. This simple relationship was affected by various constitutional developments in Great Britain and the Empire: (*a*) the growth of representative institutions; (*b*) Parliamentary sovereignty; (*c*) responsible government; (*d*) Colonial self-government; (*e*) the Federal system of government in Canada; and (*f*) the growth of the British Commonwealth of nations. Sect. 132 of the British North America Act does not provide for the withdrawal from the competence of the Provinces of matters allocated to them by the other provisions of the British North America Act—it merely gave the Parliament of Canada or the Dominion executive an overriding power. The power of legislating under the initial words of s. 91 of the British North America Act is an overriding power, to be exercised in a national emergency. [Reference was made to the *Aeronautics* case (1); and to arts. 407 and 408 of the Treaty of Versailles.]

With regard to the two propositions which I mentioned in opening, what are the treaty-making authorities to which the Dominion can conceivably point in this case? There are a number of possible authorities: (1.) The two Houses of Parliament which passed the resolutions; (2.) the Governor-General; (3.) the Governor-General in Council; (4.) the Dominion Cabinet; (5.) the Secretary of State for External Affairs; and (6.) Parliament. If the Dominion through any of these authorities has the right to exercise sovereign power over the Provinces in relation to treaty making, it must come from one of four sources: (1.) From the King by direct delegation; (2.) from the King by delegation acquiesced in; (3.) from Imperial statute; and (4.) from Dominion statute. No power from any source was given to any of the above bodies to enter into treaties binding upon the Provinces of Canada. The Dominion can only enter into agreements with other States in respect of matters which fall within her legislative competence.

The appellant has taken the position that in the *Radio* case (2) the Board decided that treaty obligations arising under international law were equivalent in all respects to contractual obligations arising under private law, and governed on all points by like principles. In other words, the Dominion maintains in the present case that the *Radio* case (2) decided that Canada by virtue of its new status—the Dominion authority having charge of external affairs—had acquired a capacity to contract, and that that capacity on the analogy of the principles of private law embraces, or extends to, not only the formation but the performance of contractual obligations. By advancing those proposals the Dominion reaches the position where it contends that the Parliament of Canada has achieved supremacy over the Provinces. The answer to that is that the acquisition of the new status which Canada is supposed to have achieved

(1) [1932] A. C. 54.

(2) [1932] A. C. 304.

affects nothing more than the constitutional position of Downing Street. If by virtue of a new status Canada is to have the right by treaties to change the law of the Provinces it should be by constitutional amendment.

The real gist of the judgment in the *Radio* case (1) is that radio was a new subject not embraced within the enumerated heads of s. 92 of the British North America Act, and that it fell either within the enumerated heads of s. 91 or within the residuary powers of the Dominion. If the principles in the judgment of the Chief Justice in the present case stand the Canadian Parliament has achieved supremacy, within limits, over the Provinces. It has never had it before, and it means that the principle enunciated by this Board about the object of the British North America Act in numerous cases is completely destroyed. [Reference was made to ***Liquidators of the Maritime Bank of Canada* v. *Receiver-General of New Brunswick*** (2).] With regard to the position taken by Ontario so far as they based their suggestion that this legislation should stand on the ground of expediency, New Brunswick cannot accede to that principle in the case of constitutional legislation. What is good for one Province is not necessarily good for another.

J. W. de B. Farris K.C. and ***Wilfrid Barton*** for the Attorney-General for British Columbia. British Columbia also wishes to dissociate itself from the submissions of Ontario supporting the legislation on the ground that it is intra vires the Dominion Parliament under the power conferred by s. 91 to make laws for the peace, order, and good government of Canada. If the legislation be upheld on that ground it will be even more fatal, even more of an invasion of Provincial rights, than if it is upheld under treaty-making powers. It would mean a declaration by the Board that matters which have in each Province been specifically set aside for that Province under s. 92 can now, by what is termed a change in recognition of conditions, be entirely eliminated from s. 92 and put into s. 91. [Reference was made to *Attorney-General for Ontario* v. *Attorney-General for the Dominion* (3); *Toronto Electric Commissioners* v. *Snider*. (4)]

---

(1) [1932] A. C. 304.
(2) [1892] A. C. 437.
(3) [1896] A. C. 348, 361.
(4) [1925] A. C. 396, 410.

If the Federal legislation be upheld it will mean that the legislation of British Columbia dealing with matters similar to those dealt with by the legislation in question must go by the board. There is surely constitutional precedent for legislation by subordinate powers legislating to fulfil international obligations of the supreme authority. There are Provinces in Canada fully clothed with constitutional power to implement the obligations of the conventions. If there be now some added power given to Canada by her new relationship in the Empire which did not exist in 1867, while she may acquire that power in connection with her relations with foreign countries she has not acquired it in the sense of being given an overriding power that she never had in the balance of these two sections—91 and 92. [The preamble to the Statute of Westminster, 1931 (22 Geo. 5, c. 4), was read.] It is the nature of the subject-matter itself which determines the class into which it falls. The British North America Act, 1867, has been said to be in the nature of a treaty by which the Provinces surrendered certain of their rights and preserved others. The matters dealt with by the present legislation fall within s. 92—property and civil rights in the Province—and are therefore within the exclusive legislative competence of the Provinces. [Reference was made to the *Radio* case (1) and the *Aeronautics* case (2).]

With regard to art. 405 of the Treaty of Versailles, the Dominion has not brought the draft conventions before the authority or authorities "within whose competence the matter lies," and has not obtained the consent of those authorities as required by art. 405, paras. 5 and 7. As to s. 132 of the British North America Act, in cases of treaties where the subject-matter is, as it is in the present instance, clearly within s. 92, and where legislation by the Provinces, if enacted, is not only adequate, but is the best form of legislation to have, then it is neither necessary nor proper for the Dominion to step in until the Province has had a chance. The Provinces have been given no opportunity after ratification of saying whether they are prepared to fulfil their obligations. [Reference was made to *City of Montreal* v. *Montreal Street Railway*. (3)]

---

(1) [1932] A. C. 304, 312.
(2) [1932] A. C. 54, 74, 76.
(3) [1912] A. C. 333, 345.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA
v.
ATTORNEY-GENERAL FOR ONTARIO.

Roebuck K.C. said that in treaties affecting subject-matters within the legislative competence of the Provincial Legislatures and bringing into operation the provisions of s. 132 of the British North America Act the King should give his assent on the advice of his Provincial advisers as distinct from his Dominion advisers. It must be in respect of matters within the ordinary Dominion competence when the Dominion Ministers advise. There is nothing in the British North America Act which suggests that foreign affairs as affecting Provincial jurisdiction have been committed to the Dominion Government. The Province is as equally sovereign as the Dominion in its own sphere.

Robertson K.C. replied. There is a chain of obligations arising under the Treaty of Versailles—not created by the Treaty—in the performance of which Canada was bound to pass the legislation in question, and to pass it under s. 132 of the British North America Act. The Provinces have no status to enter into international obligations of any kind. They have only Provincial jurisdiction legislatively. Canada has the right to enter into international obligations so far as Canada is concerned. With regard to the growth and development of the treaty-making power, Canada has a duty to make treaties; nobody else can make them for her, and the question is, can she perform the treaties? If the argument for the Provinces is right, then at the same time that Canada's power and duty with respect to the making of treaties was growing her ability to perform them was being automatically lessened. One of the things upon which the parties were able to agree at confederation in respect of matters not provided for, not foreseen, was that they were to go to the Dominion. One of the outstanding dangers at the time of confederation, and to-day, is that of sectional interests and prejudices and private interests interfering with the good government of Canada as a whole. Reliance is placed on the residuary powers as covering the performance of treaty obligations: the *Radio* case. (1) [Reference was also made to *Fort Frances Pulp and Power Co.* v. *Manitoba Free Press Co.* (2);

---

(1) [1932] A. C. 304, 311, 313 (2) [1923] A. C. 695

J. C.
1937
ATTORNEY-GENERAL FOR CANADA
v.
ATTORNEY-GENERAL FOR ONTARIO.

When a matter has attained an importance which outweighs the civil right of the individual, once it has reached that stage, then the civil right is lost sight of and the matter from an international aspect outshines it and is the one to which attention should be directed. Here an international obligation has arisen and it is the duty of Canada to see that that obligation is performed. Canada alone can perform it, and Canada, therefore, in these particular circumstances and while the obligation endures, is the body to legislate because it is an international obligation. [Reference was made to *Bank of Toronto* v. *Lambe*. (1)] Is not the proper view that once Canada has properly created international obligations then it is necessary for the peace, order and good government of the Dominion that Canada should perform them? It is submitted that that is what is meant by the *Radio* case. (2)

1937. Jan. 28. The judgment of their Lordships was delivered by LORD ATKIN. This is one of a series of cases brought before this Board on appeal from the Supreme Court of Canada on references by the Governor-General in Council to determine the validity of certain statutes of Canada passed in 1934 and 1935. Their Lordships will deal with all the appeals in due course, but they propose to begin with that involving The Weekly Rest in Industrial Undertakings Act, The Minimum Wages Act and The Limitation of Hours of Work Act, both because of the exceptional importance of the issues involved and because it affords them an opportunity of stating their opinion upon some matters which also arise in the other cases. At the outset they desire to express their appreciation of the valuable assistance which they have received from counsel, both for the Dominion and for the respective Provinces. No pains have been spared to place before the Board all the material both as to the facts and the law which could assist the Board in their responsible task. The arguments were cogent and not diffuse. The statutes in question in the present case were passed, as their titles recite, in accordance with conventions adopted by the

---

(1) (1887) 12 App. Cas. 575, 586. (2) [1932] A. C. 304

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

International Labour Organization of the League of Nations in accordance with the Labour Part of the Treaty of Versailles of June 28, 1919. It was admitted at the bar that each statute affects property and civil rights within each Province; and that it was for the Dominion to establish that nevertheless the statute was validly enacted under the legislative powers given to the Dominion Parliament by the British North America Act, 1867. It was argued for the Dominion that the legislation could be justified either (1.) under s. 132 of the British North America Act as being legislation " necessary or proper for performing the obligations of Canada, or of any Province thereof, as part of the British Empire, towards foreign countries, arising under treaties between the Empire and such foreign countries," or (2.) under the general powers, sometimes called the residuary powers, given by s. 91 to the Dominion Parliament to make laws for the peace, order and good government of Canada in relation to all matters not coming within the classes of subjects by this Act assigned exclusively to the Legislatures of the Provinces.

The Provinces contended :—

As to (1.)—(*a*) That the obligations, if any, of Canada under the labour conventions did not arise under a treaty or treaties made between the Empire and foreign countries: and that therefore s. 132 did not apply. (*b*) That the Canadian Government had no executive authority to make any such treaty as was alleged. (*c*) That the obligations said to have been incurred, and the legislative powers sought to be exercised, by the Dominion were not incurred and exercised in accordance with the terms of the Treaty of Versailles.

As to (2.), that if the Dominion had to rely only upon the powers given by s. 91, the legislation was invalid, for it related to matters which came within the classes of subjects exclusively assigned to the Legislatures of the Provinces—namely, property and civil rights in the Province.

In order to indicate the opinion of the Board upon these contentions it will be necessary briefly to refer to the Treaty of Versailles, Part XIII., Labour: to the procedure prescribed by it for bringing into existence labour conventions: and to the procedure adopted in Canada in respect thereto. The Treaty of Peace, signed at Versailles on June 28, 1919, was made between the Allied and Associated Powers of the one part and Germany of the other part. The British Empire was described as one of the Principal Allied and Associated Powers, and the High Contracting Party for the British Empire was His Majesty the King, represented generally by certain of his English Ministers, and represented for the Dominion of Canada by the Minister of Justice and the Minister of Customs, and for the other Dominions by their respective Ministers. The treaty began with Part I. of the covenant of the League of Nations, by which the high contracting parties agreed to the covenant, the effect of which was that the signatories named in the annex to the covenant were to be the original members of the League of Nations. The Dominion of Canada was one of the signatories and so became an original member of the League. The treaty then proceeds in a succession of parts to deal with the agreed terms of peace, stipulations, of course, entered into not between members of the League, but between the high contracting parties, i.e., for the British Empire, His Majesty the King. Part XIII., entitled " Labour," after reciting that the object of the League of Nations is the establishment of universal peace, and that such a peace can only be established if it is based on social justice, and that social justice requires the improvement of conditions of labour throughout the world, provides that the high contracting parties agree to the establishment of a permanent organization for the promotion of the desired objects, and that the original and future members of the League of Nations shall be the members of this organization. The organization is to consist of a general conference of representatives of the members and an International Labour Office. After providing for meetings of the conference and for its procedure the treaty contains arts. 405 and 407 :—

J. C.
1937
ATTORNEY-GENERAL FOR CANADA v. ATTORNEY-GENERAL FOR ONTARIO.

" ARTICLE 405.

" (1.) When the Conference has decided on the adoption of proposals with regard to an item in the agenda, it will rest with the Conference to determine whether these proposals should take the form: (*a*) of a recommendation to be submitted to the Members for consideration with a view to effect being given to it by national legislation or otherwise, or (*b*) of a draft international convention for ratification by the Members.

" (2.) In either case a majority of two-thirds of the votes cast by the Delegates present shall be necessary on the final vote for the adoption of the recommendation or draft convention, as the case may be, by the Conference.

" (3.) In framing any recommendation or draft convention of general application the Conference shall have due regard to those countries in which climatic conditions, the imperfect development of industrial organization or other special circumstances make the industrial conditions substantially different and shall suggest the modifications, if any, which it considers may be required to meet the case of such countries.

" (4.) A copy of the recommendation or draft convention shall be authenticated by the signature of the President of the Conference and of the Director and shall be deposited with the Secretary-General of the League of Nations. The Secretary-General will communicate a certified copy of the recommendation or draft convention to each of the Members.

" (5.) Each of the Members undertakes that it will, within the period of one year at most from the closing of the session of the Conference, or if it is impossible owing to exceptional circumstances to do so within the period of one year, then at the earliest practicable moment and in no case later than eighteen months from the closing of the session of the Conference, bring the recommendation or draft convention before the authority or authorities within whose competence the matter lies, for the enactment of legislation or other action.

" (6.) In the case of a recommendation, the Members will inform the Secretary-General of the action taken.

" (7.) In the case of a draft convention, the Member will, if it obtains the consent of the authority or authorities within whose competence the matter lies, communicate the formal ratification of the convention to the Secretary-General and will take such action as may be necessary to make effective the provisions of such convention.

" (8.) If on a recommendation no legislative or other action is taken to make a recommendation effective, or if the draft convention fails to obtain the consent of the authority or authorities within whose competence the matter lies, no further obligation shall rest upon the Member.

" (9.) In the case of a federal State, the power of which to enter into conventions on labour matters is subject to limitations, it shall be in the discretion of that Government to treat a draft convention to which such limitations apply as a recommendation only, and the provisions of this Article with respect to recommendations shall apply in such case.

" (10.) The above Article shall be interpreted in accordance with the following principle:—

" In no case shall any Member be asked or required, as a result of the adoption of any recommendation or draft convention by the Conference, to lessen the protection afforded by its existing legislation to the workers concerned.

" ARTICLE 407.

" If any convention coming before the Conference for final consideration fails to secure the support of two-thirds of the votes cast by the Delegates present, it shall nevertheless be within the right of any of the Members of the Permanent Organization to agree to such convention among themselves.

" Any convention so agreed to shall be communicated by the Governments concerned to the Secretary-General of the League of Nations, who shall register it."

It will be observed that a draft convention is adopted by a majority of two-thirds of the delegates present: and that at the stage of adoption it has no binding effect on the members: nor do the delegates of members sign it or purport to enter into an obligation on behalf of the members whose delegates they are. " Ratification," therefore, as used in para. 7 of art. 405 is not used in the ordinary sense in which it is used in respect of treaties, the formal adoption by the high contracting party of a previous assent conveyed by the signature of so-called plenipotentiaries. " Consent to " or " accession to " would perhaps better describe the transaction which involves the creation for the first time of any obligation under the convention.

In accordance with the provisions of Part XIII. draft conventions were adopted by general conferences of the International Labour Organization as follows :—

October 29—November 29, 1919, Conference.

Draft Convention limiting the hours of work in industrial undertakings.

October 25—November 19, 1921, Conference.

Draft Convention concerning the application of the weekly rest in industrial undertakings.

May 30—June 16, 1928, Conference.

Draft Convention concerning the creation of minimum wage-fixing machinery.

Each of the conventions included stipulations purporting to bind members who ratified it to carry out its provisions, the first two conventions by named dates—namely, July 1, 1921, and January 1, 1924, respectively. These three conventions were in fact ratified by the Dominion of Canada, Hours of Work on March 1, 1935, Weekly Rest on March 1, 1935, and Minimum Wages on April 12, 1935.

In each case in February and March, 1935, there had been passed resolutions of the Senate and House of Commons of Canada approving them. The ratification was approved by order of the Governor-General in Council, was recorded in an instrument of ratification executed by the Secretary of State for External Affairs for Canada, Mr. Bennett, and was duly communicated to the Secretary-General of the League of Nations. The statutes, which in substance give effect to the draft conventions, were passed by the Parliament of Canada and received the Royal Assent, " Hours of Work," on July 5, 1935, to come into force three months after assent ; " Weekly Rest," on April 4, 1935, to come into force three months after assent ; " Minimum Wage," on July 28, 1935, to come into force, so far as the convention provisions are concerned, when proclaimed by the Governor in Council, an event which has not yet happened. In 1925 the Governor-General in Council referred to the Supreme Court questions as to the obligations

of Canada under the provisions of Part XIII. of the Treaty of Versailles, and as to whether the Legislatures of the Provinces were the authorities within whose competence the subject-matter of the conventions lay. The answers to the reference, which are to be found in *In re Legislative Jurisdiction over Hours of Labour* (1), were that the Legislatures of the Provinces were the competent authorities to deal with the subject-matter, save in respect of Dominion servants, and the parts of Canada not within the boundaries of any Province : and that the obligation of Canada was to bring the convention before the Lieutenant-Governor of each Province to enable him to bring the appropriate subject-matter before the Legislature of his Province, and to bring the matter before the Dominion Parliament in respect of so much of the convention as was within their competence. This advice appears to have been accepted, and no further steps were taken until those which took place as stated above in 1935.

Their Lordships, having stated the circumstances leading up to the reference in this case, are now in a position to discuss the contentions of the parties which were summarized earlier in this judgment. It will be essential to keep in mind the distinction between (1.) the formation, and (2.) the performance, of the obligations constituted by a treaty, using that word as comprising any agreement between two or more sovereign States. Within the British Empire there is a well-established rule that the making of a treaty is an executive act, while the performance of its obligations, if they entail alteration of the existing domestic law, requires legislative action. Unlike some other countries, the stipulations of a treaty duly ratified do not within the Empire, by virtue of the treaty alone, have the force of law. If the national executive, the government of the day, decide to incur the obligations of a treaty which involve alteration of law they have to run the risk of obtaining the assent of Parliament to the necessary statute or statutes. To make themselves as secure as possible they will often in such cases before final ratification seek to obtain from Parliament an expression of approval. But it has never been suggested, and it is not the law, that such an expression of approval operates as law, or that in law it precludes the assenting Parliament, or any subsequent Parliament, from refusing to give its sanction to any legislative proposals that may subsequently be brought before it. Parliament, no doubt, as the Chief Justice points out, has a constitutional control over the executive: but it cannot be disputed that the creation of the obligations undertaken in treaties and the assent to their form and quality are the function of the executive alone. Once they are created, while they bind the State as against the other contracting parties, Parliament may refuse to perform them and so leave the State in default. In a unitary State whose Legislature possesses unlimited powers the problem is simple. Parliament will either fulfil or not treaty obligations imposed upon the State by its executive. The nature of the obligations does not affect the complete authority of the Legislature to make them law if it so chooses. But in a State where the Legislature does not possess absolute authority, in a federal State where legislative authority is limited by a constitutional document, or is divided up between different Legislatures in accordance with the classes of subject-matter submitted for legislation, the problem is complex. The obligations imposed by treaty may have to be performed, if at all, by several Legislatures; and the executive have the task of obtaining the legislative assent not of the one Parliament to whom they may be responsible, but possibly of several Parliaments to whom they stand in no direct relation. The question is not how is the obligation formed, that is the function of the executive; but how is the obligation to be performed, and that depends upon the authority of the competent Legislature or Legislatures.

---

(1) [1925] Can. S. C. R. 505.

Reverting again to the original analysis of the contentions of the parties, it will be seen that the Provincial contention 1. (*b*) relates only to the formation of the treaty obligation, while 1. (*c*) has reference to the alleged limitation of both executive and legislative action by the express terms of the treaty. If, however, the Dominion Parliament was never

vested with legislative authority to perform the obligation these questions do not arise. And, as their Lordships have come to the conclusion that the reference can be decided upon the question of legislative competence alone, in accordance with their usual practice in constitutional matters they refrain from expressing any opinion upon the questions raised by the contentions 1. (*b*) and (*c*), which in that event become immaterial. Counsel did not suggest any doubt as to the international status which Canada had now attained, involving her competence to enter into international treaties as an international juristic person. Questions were raised both generally as to how the executive power was to be exercised to bind Canada, whether it must be exercised in the name of the King, and whether the prerogative right of making treaties in respect of Canada was now vested in the Governor-General in Council, or his Ministers, whether by constitutional usage or otherwise, and specifically in relation to the draft conventions as to the interpretation of the various paragraphs in art. 405 of the Treaty of Versailles, and as to the effect of the time limits expressed both in art. 405 and in the conventions themselves. Their Lordships mention these points for the purpose of making it clear that they express no opinion upon them.

The first ground upon which counsel for the Dominion sought to base the validity of the legislation was s. 132. So far as it is sought to apply this section to the conventions when ratified the answer is plain. The obligations are not obligations of Canada as part of the British Empire, but of Canada, by virtue of her new status as an international person, and do not arise under a treaty between the British Empire and foreign countries. This was clearly established by the decision in the *Radio* case (1), and their Lordships do not think that the proposition admits of any doubt. It is unnecessary, therefore, to dwell upon the distinction between legislative powers given to the Dominion to perform obligations imposed upon Canada as part of the Empire by an Imperial executive responsible to and controlled by the

(1) [1932] A. C. 304.

Imperial Parliament, and the legislative power of the Dominion to perform obligations created by the Dominion executive responsible to and controlled by the Dominion Parliament. While it is true, as was pointed out in the *Radio* case (1), that it was not contemplated in 1867 that the Dominion would possess treaty-making powers, it is impossible to strain the section so as to cover the uncontemplated event. A further attempt to apply the section was made by the suggestion that while it does not apply to the conventions, yet it clearly applies to the Treaty of Versailles itself, and the obligations to perform the conventions arise " under " that treaty because of the stipulations in Part XIII. It is impossible to accept this view. No obligation to legislate in respect of any of the matters in question arose until the Canadian executive, left with an unfettered discretion, of their own volition acceded to the conventions, a novus actus not determined by the treaty. For the purposes of this legislation the obligation arose under the conventions alone. It appears that all the members of the Supreme Court rejected the contention based on s. 132, and their Lordships are in full agreement with them.

If, therefore, s. 132 is out of the way, the validity of the legislation can only depend upon ss. 91 and 92. Now it had to be admitted that normally this legislation came within the classes of subjects by s. 92 assigned exclusively to the Legislatures of the Provinces, namely—property and civil rights in the Province. This was in fact expressly decided in respect of these same conventions by the Supreme Court in 1925. How, then, can the legislation be within the legislative powers given by s. 91 to the Dominion Parliament? It is not within the enumerated classes of subjects in s. 91: and it appears to be expressly excluded from the general powers given by the first words of the section. It appears highly probable that none of the members of the Supreme Court would have departed from their decision in 1925 had it not been for the opinion of the Chief Justice that the judgments of the Judicial Committee in the *Aeronautics* case (2) and

---

(1) [1932] A. C. 304.

(2) [1932] A. C. 54.

the *Radio* case (1) constrained them to hold that jurisdiction to legislate for the purpose of performing the obligation of a treaty resides exclusively in the Parliament of Canada. Their Lordships cannot take this view of those decisions. The *Aeronautics* case (2) concerned legislation to perform obligations imposed by a treaty between the Empire and foreign countries. Sect. 132, therefore, clearly applied, and but for a remark at the end of the judgment, which in view of the stated ground of the decision was clearly obiter, the case could not be said to be an authority on the matter now under discussion. The judgment in the *Radio* case (1) appears to present more difficulty. But when that case is examined it will be found that the true ground of the decision was that the convention in that case dealt with classes of matters which did not fall within the enumerated classes of subjects in s. 92, or even within the enumerated classes in s. 91. Part of the subject-matter of the convention, namely—broadcasting, might come under an enumerated class, but if so it was under a heading " Inter-provincial Telegraphs," expressly excluded from s. 92. Their Lordships are satisfied that neither case affords a warrant for holding that legislation to perform a Canadian treaty is exclusively within the Dominion legislative power.

For the purposes of ss. 91 and 92, i.e., the distribution of legislative powers between the Dominion and the Provinces, there is no such thing as treaty legislation as such. The distribution is based on classes of subjects; and as a treaty deals with a particular class of subjects so will the legislative power of performing it be ascertained. No one can doubt that this distribution is one of the most essential conditions, probably the most essential condition, in the inter-provincial compact to which the British North America Act gives effect. If the position of Lower Canada, now Quebec, alone were considered, the existence of her separate jurisprudence as to both property and civil rights might be said to depend upon loyal adherence to her constitutional right to the exclusive competence of her own Legislature in these matters. Nor is

---

(1) [1932] A. C. 304.

(2) [1932] A. C. 54.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA
v.
ATTORNEY-GENERAL FOR ONTARIO.

it of less importance for the other Provinces, though their law may be based on English jurisprudence, to preserve their own right to legislate for themselves in respect of local conditions which may vary by as great a distance as separates the Atlantic from the Pacific. It would be remarkable that while the Dominion could not initiate legislation, however desirable, which affected civil rights in the Provinces, yet its Government not responsible to the Provinces nor controlled by Provincial Parliaments need only agree with a foreign country to enact such legislation, and its Parliament would be forthwith clothed with authority to affect Provincial rights to the full extent of such agreement. Such a result would appear to undermine the constitutional safeguards of Provincial constitutional autonomy.

It follows from what has been said that no further legislative competence is obtained by the Dominion from its accession to international status, and the consequent increase in the scope of its executive functions. It is true, as pointed out in the judgment of the Chief Justice, that as the executive is now clothed with the powers of making treaties so the Parliament of Canada, to which the executive is responsible, has imposed upon it responsibilities in connection with such treaties, for if it were to disapprove of them they would either not be made or the Ministers would meet their constitutional fate. But this is true of all executive functions in their relation to Parliament. There is no existing constitutional ground for stretching the competence of the Dominion Parliament so that it becomes enlarged to keep pace with enlarged functions of the Dominion executive. If the new functions affect the classes of subjects enumerated in s. 92 legislation to support the new functions is in the competence of the Provincial Legislatures only. If they do not, the competence of the Dominion Legislature is declared by s. 91 and existed ab origine. In other words, the Dominion cannot, merely by making promises to foreign countries, clothe itself with legislative authority inconsistent with the constitution which gave it birth.

But the validity of the legislation under the general words

J. C.
1937
ATTORNEY-GENERAL FOR CANADA
v.
ATTORNEY-GENERAL FOR ONTARIO.

of s. 91 was sought to be established not in relation to the treaty-making power alone, but also as being concerned with matters of such general importance as to have attained "such dimensions as to affect the body politic," and to have "ceased to be merely local or provincial," and to have "become matter of national concern." It is interesting to notice how often the words used by Lord Watson in *Attorney-General for Ontario* v. *Attorney-General for the Dominion* (1) have unsuccessfully been used in attempts to support encroachments on the Provincial legislative powers given by s. 92. They laid down no principle of constitutional law, and were cautious words intended to safeguard possible eventualities which no one at the time had any interest or desire to define. The law of Canada on this branch of constitutional law has been stated with such force and clarity by the Chief Justice in his judgment in the reference concerning the Natural Products Marketing Act (2) dealing with the six Acts there referred to, that their Lordships abstain from stating it afresh. The Chief Justice, naturally from his point of view, excepted legislation to fulfil treaties. On this their Lordships have expressed their opinion. But subject to this, they agree with and adopt what was there said. They consider that the law is finally settled by the current of cases cited by the Chief Justice on the principles declared by him. It is only necessary to call attention to the phrases in the various cases, "abnormal circumstances," "exceptional conditions," "standard of necessity" (*Board of Commerce* case (3)), "some extraordinary peril to the national life of Canada," "highly exceptional," "epidemic of pestilence" (*Snider's* case (4)), to show how far the present case is from the conditions which may override the normal distribution of powers in ss. 91 and 92. The few pages of the Chief Justice's judgment will, it is to be hoped, form the locus classicus of the law on this point, and preclude further disputes.

It must not be thought that the result of this decision is

---

(1) [1896] A. C. 348.

(2) [1936] Can. S. C. R. 398, at 414 et seq.

(3) [1922] 1 A. C. 191.

(4) [1925] A. C. 396.

J. C.
1937
ATTORNEY-GENERAL FOR CANADA
v.
ATTORNEY-GENERAL FOR ONTARIO.

that Canada is incompetent to legislate in performance of treaty obligations. In totality of legislative powers, Dominion and Provincial together, she is fully equipped. But the legislative powers remain distributed, and if in the exercise of her new functions derived from her new international status Canada incurs obligations they must, so far as legislation be concerned, when they deal with Provincial classes of subjects, be dealt with by the totality [illegible], in other words by co-operation between the [illegible] and the Provinces. While the ship of state now sails on larger ventures and into foreign waters she still retains the watertight compartments which are an essential part of her original structure. The Supreme Court was equally divided and therefore the formal judgment could only state the opinions of the three judges on either side. Their Lordships are of opinion that the answer to the three questions should be that the Act in each case is ultra vires of the Parliament of Canada, and they will humbly advise His Majesty accordingly.

Solicitors for the Attorney-General for Canada: *Charles Russell & Co.*

Solicitors for the Attorneys-General for Ontario and New Brunswick: *Blake & Redden.*

Solicitors for the Attorney-General for British Columbia: *Gard, Lyell & Co.*

[PRIVY COUNCIL.]

ATTORNEY-GENERAL FOR CANADA . . . APPELLANT;

AND

ATTORNEY-GENERAL FOR ONTARIO AND OTHERS . . . . RESPONDENTS.

J. C.*
1937
Jan. 28.

ON APPEAL FROM THE SUPREME COURT OF CANADA.

Canada—Dominion Statute—Constitutional validity—Compulsory unemployment insurance legislation—Insurance Act affecting civil rights in the Province—Within exclusive Provincial legislative competence—Invalid Dominion legislation—No severance—No special national emergency—British North America Act, 1867 (30 & 31 *Vict. c.* 3), *s.* 92 (13)—*Employment and Social Insurance Act,* 1935, *St. Can.* (25 & 26 *Geo.* 5, *c.* 38).

The Employment and Social Insurance Act, 1935, of the Parliament of Canada, which in substance provided for a system of compulsory unemployment insurance throughout Canada, was ultra vires of the Dominion Parliament. In pith and substance the Act was an insurance Act affecting the civil rights of employers and employed in each Province and was accordingly within the exclusive competence of the Provincial Legislatures under s. 92, head 13, of the British North America Act, 1867, which provided that "In each Province the Legislature may exclusively make laws in relation to . . . . (13) Property and civil rights in the Province."

The Act did not purport to deal with, and could not be supported on the ground of, any special emergency arising from the degree of unemployment in Canada at the relevant date.

The other parts of the Act were so inextricably mixed up with the insurance provisions of Part III. that it was impossible to sever them, and the whole Act was therefore ultra vires and invalid.

Judgment of the Supreme Court of Canada [1936] Can. S. C. R. 427 affirmed.

APPEAL (No. 101 of 1936), by special leave, from a judgment of the Supreme Court of Canada (June 17, 1936) answering the following question referred to the Court by the Governor-General in Council by an Order dated November 5, 1935: "Is the Employment and Social Insurance Act, or any of the provisions thereof and in what particular or particulars or to what extent, ultra vires of the Parliament of Canada?" The

---

* *Present:* LORD ATKIN, LORD THANKERTON, LORD MACMILLAN, LORD WRIGHT M.R., and SIR SIDNEY ROWLATT.

Senator FORD. So if this is not cleared up, this is one Senator who is not going to support the so-called free trade agreement. I do not care if you get—wait until they start buying Louisiana sweet to generate, I started to say to the Chairman a while go. That is a type of oil, as you know, down in Louisiana. I do not want you to get any different connotation on that.

But you start generating with Louisiana sweet, that is about $18, $19 today.

So that is in the record, and I hope it is understood what it says and what that means and what the attorney general of Canada said, and I think—of the province of Ontario, rather. I am sorry. So I stand corrected by the learned gentleman to my rear, and that is the reason he is around, he is learned.

That is all I have.

Senator Conrad, would you like to proceed?

Senator CONRAD. I would. Thank you, Mr. Acting Chairman.

I am very interested in any analysis that your organization has done on potential displacement of coal production in our country as a result of the free trade agreement. Specifically, I asked Ambassador Yeutter yesterday if there had been any analysis of the effect on specific industries.

He said there was a potential one percent displacement on the U.S. coal market as a result of this agreement. That is, we would lose about one percent of our market as a result of it.

I asked him where would that displacement occur because one percent sounded like a real small number, unless it all shows up in my state, and then maybe you are talking about 25 or 30 percent of the market in North Dakota. In that case, we are talking about big numbers.

I am very interested if you or your organization has looked at those questions. And I want to follow up with some other questions that go to the question of electricity production and the differentials between Canada's situation and ours.

Maybe you could respond to the first question.

Mr. ALTMEYER. Senator, the National Coal Association did an analysis of the displacement of coal production by Canadian power imports between 1981 and 1985, through the end of 1985. We found, I believe in the statement it is reflected, a displacement of 6.3 million tons of U.S. coal.

In the Mid-American Power Pool region, which includes North Dakota and South Dakota and Minnesota, of that 6.3 million tons of displacement, 4.7 million occurred. That displacement was North Dakota coal.

Senator CONRAD. 4.7 million of the 6.3?

Mr. ALTMEYER. Yes, sir.

We are currently doing a projection of the potential for displacement between 1986 and 1985, which we hope to have completed by the end of April, and we would be happy to submit that to you, Senator.

Senator CONRAD. You are saying 75 percent of the loss is going to occur in my state?

Mr. ALTMEYER. Seventy-five percent of the loss that has already occurred has occurred in your state.

Senator CONRAD. Of potential loss, what would we be looking at?

Mr. **Altmeyer**. We do not have a projection. Our preliminary analysis indicated an aggregate displacement of 24——

Senator **Conrad**. Let me understand. We have already lost 6.3 million tons of U.S. coal production a year due to imports of electricity generated in Canada?

Mr. **Altmeyer**. Yes, Senator.

Senator **Conrad**. That has no relationship to the Free Trade Agreement?

Mr. **Altmeyer**. That is correct, Senator.

Senator **Conrad**. This is what we have lost as a result of what?

Mr. **Altmeyer**. As a result of exports of power from Saskatchewan and Manitoba into, predominantly into Minnesota. That has resulted in two things:

One is, power that would have been generated in North Dakota and exported to Minnesota, Minnesota utilities not needing that power.

A second factor that would account for displacement that will be occurring after this year is, Basin Electric had planned to build a unit called Antelope 4, where they have now put that on deferral. It was a permitted facility. There is not a market for that.

Northern States Power in Minnesota had planned to build a unit named Garrison in North Dakota using North Dakota coal. They have now deferred any plans for construction of that unit.

The power that would have been supplied by Antelope 4 or Garrison is being replaced by power imported from Manitoba and Saskatchewan.

Senator **Conrad**. All right. Let me probe this a little further. I am interested in what effect the free trade agreement might or might not have. I assume that we would be precluded, would we not, from any protection of our market if the free trade agreement were to go forward?

Mr. **Altmeyer**. The laws relative to countervailing duty and antidumping remain in place and are effective following the free trade agreement. If it is demonstrated that Canada is dumping power or there is a situation that would be counteravailable under the trade laws, those remedies are available.

Senator **Conrad**. Well, let me pursue this a little further in a different vein. One of the problems that we think we have is Canada sits up there with coal-fired plants, and I would be the first one to say most of the power coming in is hydro.

But my understanding from the testimony we have received earlier is that about 25 percent is from coal-fired plants. They do not have scrubber number one in all of Canada. And we have spent hundreds of millions of dollars in my state on scrubbers.

If we were to seek from the federal government a legislative vehicle that would prevent them from sending power down that was not scrubbed from their coal-fired plants, would the Free Trade Agreement preclude us in your judgment from doing that?

Mr. **Altmeyer**. Senator, it would only preclude us from doing that to the extent that we did not require that of all domestic utilities. For us to require only scrubbed, you know, electricity from scrubbed coal to come from Canada, we would have to make a similar requirement applicable to all domestic power transfers also.

So if we are willing to do it to ourselves, we could do it to them. If we were unwilling to do it to ourselves, we would be precluded from doing it. That would be discriminatory treatment and would violate the free trade agreement.

Senator CONRAD. So the scheme that we have in this country, in which we in effect require scrubbers in order to reach the attainment standards, could be applied to them?

Mr. ALTMEYER. If we chose——

Senator CONRAD. Air quality standards that we have in this country could be applied to them, as long as it was equivalent treatment, is that the answer?

Mr. ALTMEYER. As long as it is equivalent treatment, yes, Senator. And I think the more correct nomenclature would probably from a technical standpoint not be air quality standards, but emissions standards; as opposed to ambient air quality, actual source emission standards.

Senator CONRAD. What is the official position of the National Coal Association? I am sorry, I was not here to hear your testimony earlier.

Is the Coal Association supporting, opposing, or not taking a position on the free trade agreement?

Mr. ALTMEYER. We do not currently have a position. Generally speaking, the membership of National Coal supports free trade. We export 16 to 18 million tons of coal a year to Canada.

There are definitely benefits to a continuation of free trade from the coal side. We see a potential problem with respect to displacement of coal from imported power. But quite honestly, Senator, there is nothing in the free trade agreement that is going to make the ability of Canadian power producers to export power to the United States any greater than currently exists.

The only restrictions on Canadian power exports currently are self-imposed restraints by Canada. They have three pricing tests that are applicable and administered by the National Energy Board before they can export power.

Canada has agreed to eliminate one of those pricing tests in the free trade agreement.

Senator CONRAD. I have no further questions.

Senator FORD. Since this is the last hearing as relates to this subject, I will adjourn the Committee, rather than recess. So we are adjourned.

[Whereupon, at 3:50 p.m., the hearing was adjourned.]

[COMMITTEE NOTE.—Due to the voluminous nature of the responses to additional committee questions and additional materials submitted for the record they have been retained in committee files.]

○